



**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

**Consolidated Financial Statements
and Supplemental Schedules**

June 30, 2012 and 2011

(With Independent Auditors' Report Thereon)

Under provisions of state law, this report is a public document. A copy of the report has been submitted to the entity and other appropriate public officials. The report is available for public inspection at the Baton Rouge office of the Legislative Auditor and, where appropriate, at the office of the parish clerk of court.

Release Date **MAR 27 2013**

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Table of Contents

	Page(s)
Independent Auditors' Report	1
Consolidated Financial Statements	
Consolidated Balance Sheets, June 30, 2012 and 2011	3
Consolidated Statements of Operations, Years ended June 30, 2012 and 2011	4 – 5
Consolidated Statements of Changes in Net Assets, Years ended June 30, 2012 and 2011	6
Consolidated Statements of Cash Flows, Years ended June 30, 2012 and 2011	7 – 8
Notes to Consolidated Financial Statements	9 – 55
Supplemental Schedules	
1 Consolidating Schedule – Balance Sheet Information	56
2 Consolidating Schedule – Statement of Operations Information	57 – 58
3 Consolidating Schedule – Statement of Changes in Net Assets Information	59
4 Service to the Community (Unaudited)	60 – 61



KPMG LLP
Suite 1700
450 Laurel Street, Suite 1700
Baton Rouge, LA 70801

Independent Auditors' Report

The Board of Trustees
Franciscan Missionaries of
Our Lady Health System, Inc.

We have audited the accompanying consolidated balance sheets of Franciscan Missionaries of Our Lady Health System, Inc. and affiliated organizations (the System) as of June 30, 2012 and 2011, and the related consolidated statements of operations, changes in net assets, and cash flows for the years then ended. These consolidated financial statements are the responsibility of the System's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the system's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Franciscan Missionaries of Our Lady Health System, Inc. and affiliated organizations as of June 30, 2012 and 2011, and the results of their operations, changes in their net assets, and their cash flows for the years then ended, in conformity with U.S. generally accepted accounting principles.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 9, 2012, on our consideration of the System's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be considered in assessing the results of our audit.



Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplementary information included in Schedules 1 through 3 is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the consolidated financial statements. The information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the consolidated financial statements or to the consolidated financial statements themselves, and other additional procedures in accordance with the auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

Our audits were conducted for the purpose of forming an opinion on the consolidated financial statements as a whole. The supplementary information included in Schedule 4 is presented for purposes of additional analysis and is not a required part of the consolidated financial statements. Such information has not been subjected to the auditing procedures applied in the audits of the consolidated financial statements and, accordingly, we do not express an opinion or provide any assurance on it.

KPMG LLP

October 9, 2012

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Consolidated Balance Sheets

June 30, 2012 and 2011

(In thousands)

Assets	2012	2011
Current assets		
Cash and cash equivalents	\$ 190,006	218,195
Short-term investments	17,538	21,254
Patient receivables, net of allowance for uncollectible accounts of \$73,144 and \$64,441 in 2012 and 2011, respectively	191,752	175,784
Other current assets	81,714	88,980
Total current assets	481,010	504,213
Assets limited as to use, net of current portion	668,512	690,785
Property and equipment, net	999,262	944,292
Property and equipment, held for sale	—	15,055
Other assets	112,761	106,063
Total assets	\$ 2,261,545	2,260,408
Liabilities and Net Assets		
Current liabilities		
Lines of credit	\$ 5,996	4,650
Current installments of long-term debt	19,027	17,585
Current portion of capital lease obligations	5,103	4,649
Accounts payable	53,435	75,487
Other current liabilities	169,200	153,491
Total current liabilities	252,761	255,862
Professional and general liabilities	28,472	25,587
Long-term debt, excluding current installments	502,390	518,709
Capital lease obligations, excluding current portion	12,174	16,843
Accrued pension cost	304,591	176,003
Other long-term liabilities	62,200	52,782
Total liabilities	1,162,588	1,045,786
Net assets		
Unrestricted	1,065,480	1,180,209
Temporarily restricted	20,802	18,609
Permanently restricted	5,510	5,516
Total net assets attributable to Franciscan Missionaries of Our Lady Health System, Inc	1,091,792	1,204,334
Noncontrolling interests	7,165	10,288
Total net assets	1,098,957	1,214,622
Commitments and contingencies		
Total liabilities and net assets	\$ 2,261,545	2,260,408

See accompanying notes to consolidated financial statements

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Consolidated Statements of Operations

Years ended June 30, 2012 and 2011

(In thousands)

	<u>2012</u>	<u>2011</u>
Changes in unrestricted net assets		
Unrestricted revenues		
Net patient service revenue	\$ 1,319,535	1,362,922
Other revenue	89,943	86,317
Equity in income from equity investees, net	12,033	10,951
Total unrestricted revenues	<u>1,421,511</u>	<u>1,460,190</u>
Net assets released from restrictions used for operations		
Satisfaction of program restrictions	2,780	5,364
Expiration of time restrictions	133	125
Total net assets released from restrictions used for operations	<u>2,913</u>	<u>5,489</u>
Total unrestricted revenues and other support	<u>1,424,424</u>	<u>1,465,679</u>
Operating expenses:		
Salaries and wages	519,767	483,515
Employee benefits	111,761	125,264
Total salaries, wages, and employee benefits	631,528	608,779
Provision for uncollectible accounts	123,500	108,238
Physician fees	30,570	28,189
Professional services	15,973	14,817
Other services	171,469	156,997
Leases, insurance, and utilities	46,384	44,103
Supplies and other	257,758	246,479
Depreciation and amortization	79,153	68,478
Interest	26,537	21,942
Other	3,133	21,352
Total operating expenses	<u>1,386,005</u>	<u>1,319,374</u>
Operating income	<u>38,419</u>	<u>146,305</u>

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Consolidated Statements of Operations

Years ended June 30, 2012 and 2011

(In thousands)

	<u>2012</u>	<u>2011</u>
Nonoperating gains (losses)		
Investment return	\$ (5,332)	119,270
Other	(3,743)	(4,695)
Change in fair value of interest rate swap agreements	<u>(14,118)</u>	<u>4,676</u>
Total nonoperating gains (losses), net	<u>(23,193)</u>	<u>119,251</u>
Unrestricted revenues, gains, and other support in excess of expenses and losses before noncontrolling interest	15,226	265,556
Noncontrolling interests	<u>(3,126)</u>	<u>(3,145)</u>
Unrestricted revenues, gains, and other support in excess of expenses and losses attributable to Franciscan Missionaries of Our Lady Health System, Inc	12,100	262,411
Pension-related changes other than net periodic pension cost	(124,981)	69,673
Other	<u>(1,848)</u>	<u>—</u>
Increase (decrease) in unrestricted net assets	<u>\$ (114,729)</u>	<u>332,084</u>

See accompanying notes to consolidated financial statements

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Consolidated Statements of Changes in Net Assets

Years ended June 30, 2012 and 2011

(In thousands)

	<u>2012</u>	<u>2011</u>
Change in unrestricted net assets		
Unrestricted revenues, gains, and other support in excess of expenses and losses attributable to Franciscan Missionaries of Our Lady Health System, Inc	\$ 12,100	262,411
Pension-related changes other than net periodic pension cost	(124,981)	69,673
Other	<u>(1,848)</u>	<u>—</u>
Increase (decrease) in unrestricted net assets	<u>(114,729)</u>	<u>332,084</u>
Changes in temporarily restricted net assets		
Contributions	5,062	5,185
Income from long-term investments, net	1	1
Net unrealized and realized gains on investments, net	15	35
Net assets released from restrictions	(2,913)	(5,489)
Acquired net assets	<u>28</u>	<u>—</u>
Increase (decrease) in temporarily restricted net assets	<u>2,193</u>	<u>(268)</u>
Changes in permanently restricted net assets	<u>(6)</u>	<u>11</u>
Changes in noncontrolling interests		
Unrestricted revenues, gains, and other support in excess of expenses and losses	3,126	3,145
Distributions	(5,183)	(3,207)
Sale of noncontrolling interests	—	1,207
Acquired noncontrolling interest	<u>(1,066)</u>	<u>—</u>
Changes in noncontrolling interest	<u>(3,123)</u>	<u>1,145</u>
Increase (decrease) in net assets	<u>(115,665)</u>	<u>332,972</u>
Net assets, beginning of year	<u>1,214,622</u>	<u>881,650</u>
Net assets, end of year	\$ <u><u>1,098,957</u></u>	<u><u>1,214,622</u></u>

See accompanying notes to consolidated financial statements

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Consolidated Statements of Cash Flows

Years ended June 30, 2012 and 2011

(In thousands)

	<u>2012</u>	<u>2011</u>
Cash flows from operating activities		
(Decrease) increase in net assets	\$ (115,665)	332,972
Adjustments to reconcile (decrease) increase in net assets to net cash provided by operating activities		
Depreciation and amortization	79,153	68,478
Provision for uncollectible accounts	123,500	108,238
Loss on sale of property and equipment, net	2,827	2,240
Net realized and unrealized (gains) losses on assets limited as to use and investment securities	11,107	(114,438)
Income from equity investees, net of distributions	(12,033)	(10,951)
Change in value of interest rate swap agreement	14,119	(4,676)
Amortization of net premium on bond issues	(38)	(35)
Pension-related changes other than net periodic pension cost	124,981	(69,673)
Sale of noncontrolling interest	—	(1,207)
Purchase of noncontrolling interest	985	—
Distributions to noncontrolling interest	5,183	3,207
Changes in operating assets and liabilities		
Short-term investments, net	1,214	782
Receivables	(138,914)	(109,622)
Inventories	(187)	(752)
Prepaid expenses and other assets	(6,688)	(1,207)
Accounts payable, accrued expenses, and other liabilities	(3,688)	60,368
Professional and general liabilities	2,518	(767)
Net cash provided by operating activities	<u>88,374</u>	<u>262,957</u>

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Consolidated Statements of Cash Flows

Years ended June 30, 2012 and 2011

(In thousands)

	<u>2012</u>	<u>2011</u>
Cash flows from investing activities		
Capital expenditures	\$ (121,208)	(181,048)
Change in assets limited as to use	19,679	68,212
Decrease in cash and government securities held as collateral under securities lending transaction	—	154
Proceeds from sales of property and equipment	1,267	448
Distributions of investment in equity investees	7,660	9,158
Acquisition of additional interest in equity investees	—	(6,084)
Net cash used in investing activities	<u>(92,602)</u>	<u>(109,160)</u>
Cash flows from financing activities		
Decrease in liability held under securities lending transaction	—	(154)
Repayment of long-term debt	(18,124)	(16,708)
Repayment of capital lease obligations	(4,216)	(2,300)
Proceeds from issuance of note payable	3,200	2,614
Payment of bond issuance costs	—	(163)
Payments on line of credit, net	1,347	4,418
Proceeds from sale of noncontrolling interest	—	1,207
Purchase of noncontrolling interest	(985)	—
Distributions to noncontrolling interest	<u>(5,183)</u>	<u>(3,207)</u>
Net cash used in financing activities	<u>(23,961)</u>	<u>(14,293)</u>
Increase (decrease) in cash and cash equivalents	(28,189)	139,504
Cash and cash equivalents, beginning of year	<u>218,195</u>	<u>78,691</u>
Cash and cash equivalents, end of year	\$ <u><u>190,006</u></u>	<u><u>218,195</u></u>

See accompanying notes to consolidated financial statements

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

(1) Organization and Summary of Significant Accounting Policies

Franciscan Missionaries of Our Lady Health System, Inc (FMOLHS or the System) is a not-for-profit, nonstock membership corporation and is a wholly owned subsidiary of Franciscan Missionaries of Our Lady in Baton Rouge, Louisiana (FMOL) The members of FMOL are the Provincial and the members of the Council of the Franciscan Missionaries of Our Lady – North American Province FMOLHS is the sole member and has sole voting control of four medical centers and their affiliates (FMOLHS Affiliates) All of these entities are not-for-profit, nonstock membership corporations The medical centers are as follows:

- Our Lady of the Lake Regional Medical Center (the Lake) – Baton Rouge, Louisiana
- Our Lady of the Lake Ascension Community Hospital (d b.a St Elizabeth Hospital) – Gonzales, Louisiana
- Our Lady of Lourdes Regional Medical Center (Lourdes) – Lafayette, Louisiana
- St Francis Medical Center (St Francis) – Monroe, Louisiana

The FMOLHS Affiliates participate together in a captive insurance company, Louise Insurance Co , Ltd (Louise), which is wholly owned by FMOLHS (see note 18)

The following are other wholly owned affiliates of FMOLHS

- Calais Health, LLC (Calais), a limited liability Louisiana company formed to provide occupational medicine services in Louisiana, is also wholly owned by FMOLHS
- Franciscan PACE, Inc (PACE), a corporation formed to provide nonprofit health and supportive services designed to assist seniors who desire an alternative to nursing home care, is also wholly owned by FMOLHS
- Franciscan Missionaries of Our Lady Health System Management Services, L L C , a limited liability Louisiana company formed for the purpose of providing Management services to healthcare facilities, is also wholly owned by FMOLHS
- Franciscan Missionaries of Our Lady Health System Holdings, Inc is a Louisiana taxable not-for-profit subsidiary of FMOLHS formed for the purpose to hold an ownership interest in Resource Optimization and Innovation, L L C

The significant accounting policies used by FMOLHS in preparing and presenting its consolidated financial statements follow

(a) Principles of Consolidation

The consolidated financial statements include the accounts of FMOLHS, its wholly owned subsidiaries, and the FMOLHS Affiliates All significant intercompany balances and transactions have been eliminated in consolidation Third party equity interest in the consolidated subsidiaries are reflected as noncontrolling interest in the FMOLHS's consolidated financial statements For

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

subsidiaries in which FMOLHS does not have a controlling interest, FMOLHS records such investments under the equity method of accounting

(b) *Use of Estimates*

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires that management make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. The current economic environment has increased the degree of uncertainty inherent in these estimates and assumptions.

Significant items subject to such estimates and assumptions include the determination of the allowances for uncollectible accounts and contractual adjustments, reserves for general and professional liability claims, reserves for workers' compensation claims, reserves for employee healthcare claims, estimated third-party payor settlements, certain investments in alternative funds, valuation of derivatives, useful lives of property and equipment, and the actuarially determined benefit liability related to FMOLHS's pension plans and postretirement health plans. The current economic environment has increased the degree of uncertainty inherent in those estimates and assumptions. In addition, laws and regulations governing the Medicare and Medicaid programs are extremely complex and subject to interpretation. As a result, there is at least a reasonable possibility that recorded estimates related to these programs will change by a material amount in the near term.

(c) *Cash Equivalents*

Cash and cash equivalents include investments in highly liquid debt instruments with an original maturity of three months or less when purchased, excluding amounts included in assets limited as to use.

(d) *Investments and Investment Return*

Investments in equity securities with readily determinable fair values and all investments in debt securities, except for investments in the common stock of equity investees accounted for using the equity method, are recorded at fair value. The estimated fair value of these investments is based on quoted market prices.

FMOLHS also invests in alternative assets such as hedge funds, private equity funds, and commingled funds. When FMOLHS's investment in alternative assets represents investments organized as corporations, or trusts with legal structures similar to a corporation, with ownership less than 20%, and transacts frequently (at least quarterly), FMOLHS accounts for these investments at net asset value as a practical expedient to fair value. When FMOLHS's investment in alternative assets represents investments organized as limited partnerships, or limited liability companies with specific ownership accounts or trusts with legal structures similar to a partnership, FMOLHS accounts for these investments using the equity method, which generally approximates net asset value.

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

The net asset value for alternative assets for which quoted market prices are not available is based on the most recent valuations provided by the external investment managers, adjusted for receipts and disbursements through June 30. FMOLHS reviews and evaluates the values provided by the managers and agrees with the valuation methods and assumptions used to determine those values. Therefore, FMOLHS believes the carrying amount of these financial instruments is a reasonable estimate of fair value. Because alternative assets are not readily marketable, their estimated value is subject to uncertainty and, therefore, may differ from the value that would have been used had a ready market for such investments existed.

Realized and unrealized gains and losses on investments recorded at fair value and on alternative assets recorded at net asset value, and changes in the carrying value of alternative assets recorded on the equity method, are included in the consolidated statements of operations as increases or decreases in unrestricted net assets unless their use is temporarily or permanently restricted by explicit donor stipulations or law. Dividend, interest, and other investment income are recorded as increases in unrestricted net assets unless the use is restricted by donor. Donated investments are recorded at fair value at the date of receipt.

(e) Inventories

Inventories, consisting primarily of medical supplies and pharmaceuticals, are stated at the lower of cost (average cost method) or market.

(f) Assets Limited as to Use

Assets limited as to use include the following:

- Assets set aside by the Board of Directors for future capital acquisitions, capital improvements, securities lending, and debt service, over which the Board of Directors retains control and may at its discretion subsequently use for other purposes.
- Assets held by trustees under indenture agreements, self-insurance trust arrangements, and terms of donor restrictions.

Amounts required to satisfy current requirements for the payment of current construction costs and debt service costs are classified as current assets in the accompanying consolidated balance sheets.

(g) Components of Net Assets

Net assets, revenues, and other support and expenses are classified based on the existence or absence of donor-imposed restrictions. Accordingly, the net assets of FMOLHS and changes therein are classified and reported as follows:

Unrestricted Net Assets – Unrestricted net assets are net assets whose use is not restricted by donors, even though their use may be limited in other respects, such as by contracts or by board designation.

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

Temporarily Restricted Net Assets – Temporarily restricted net assets are net assets subject to donor-imposed stipulations that may or will be met either by actions of FMOLHS and/or the passage of time. When a restriction expires, temporarily restricted net assets are reclassified to unrestricted net assets and reported in the consolidated statements of operations as net assets released from restrictions

Permanently Restricted Net Assets – Permanently restricted net assets are net assets subject to donor-imposed stipulations that are maintained permanently by FMOLHS. Generally, the donors of these assets permit FMOLHS to use all or part of the income earned on related investments for specific or general purposes

Unrealized gains and losses are recorded as temporarily restricted net assets if the terms of the gift restrict the use of the income. Permanently restricted net assets are increased if the term of the gift that gave rise to the investment requires the unrealized gain be added to the principal of a permanent endowment.

Generally, losses on the investments of restricted endowments reduce temporarily restricted net assets to the extent donor-imposed temporary restrictions on net appreciation of investments have not been met before the loss occurs. Any remaining losses reduce unrestricted net assets, but can be restored through subsequent investment gains.

(h) Bond Issuance Costs

Bond issuance costs, premiums, and discounts, costs of letters of credit and standby purchase agreements are being amortized over the terms of the related bond issues using a method that approximates the effective interest method. Accumulated amortization was approximately \$5,019 and \$4,532 at June 30, 2012 and 2011, respectively.

(i) Property and Equipment

Property and equipment, including leasehold improvements, are stated at cost upon acquisition or fair value if donated. Depreciation is computed primarily on the straight-line method based upon the shorter of the estimated useful lives of the assets or the lease term. Equipment under capital lease is amortized using the straight-line method over the shorter of the lease term of the equipment or its useful life. Such amortization is included in depreciation and amortization expense in the accompanying consolidated financial statements.

Gifts of long-lived assets, such as land, buildings, or equipment, are reported as unrestricted support, unless explicit donor stipulations specify how the donated assets must be used. Gifts of long-lived assets with explicit restrictions that specify how the assets are to be used and gifts of cash or other assets that must be used to acquire long-lived assets are reported as restricted support. Absent explicit donor time stipulations about how long those long-lived assets must be maintained, expirations of donor restrictions are reported when the donated or acquired long-lived assets are placed in service. Contributions restricted for the purchase of property and equipment for which

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

restrictions are met within the same year as the contributions are received are reported as increases in unrestricted net assets in the accompanying consolidated financial statements

(j) *Cost in Excess of Net Assets Acquired*

Cost in excess of net assets acquired, or goodwill, included in other assets, is the amount by which purchase price exceeds the fair value of assets acquired

Accumulated amortization for all costs in excess of net assets acquired was \$15,846 at both June 30, 2012 and 2011

Cost in excess of net assets acquired is reviewed for impairment at least annually. The cost in excess of net assets acquired impairment test is a two-step test. Under the first step, the fair value of the reporting unit is compared with its carrying value (including cost in excess of net assets acquired). If the fair value of the reporting unit is less than its carrying value, an indication of cost in excess of net assets acquired impairment exists for the reporting unit and the enterprise must perform step two of the impairment test (measurement). Under step two, an impairment loss is recognized for any excess of the carrying amount of the reporting unit's cost in excess of net assets acquired over the implied fair value of that cost in excess of net assets acquired. The implied fair value of cost in excess of net assets acquired is determined by allocating the fair value of the reporting unit in a manner similar to a purchased price allocation and the residual fair value after this allocation is the implied fair value of the reporting unit's cost in excess of net assets acquired. Fair value of the reporting unit is determined using a discounted cash flow analysis. If the fair value of the reporting unit exceeds its carrying value, step two does not need to be performed. No impairment loss was required to be recognized in either 2012 or 2011.

The Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2011-08, *Testing Goodwill for Impairment*, in September 2011. ASU 2011-08 permits an entity to make a qualitative assessment of whether it is more likely than not that a reporting unit's fair value is less than its carrying amount before applying the two-step test for impairment of goodwill as described above. If an entity concludes that it is more likely than not that the fair value of a reporting unit is less than its carrying amount, it would not be required to perform the two-step impairment test for that reporting unit. FMOLHS expects to adopt this ASU in fiscal year 2013.

(k) *Capitalization of Interest*

FMOLHS capitalizes the interest costs of borrowings, net of related investment income on the unexpended funds, during the construction period of major projects as a component of the asset. Net interest expense capitalized was \$325 and \$4,917 for the years ended June 30, 2012 and 2011, respectively.

(l) *Impairment of Long-Lived Assets*

Long-lived assets, such as property and equipment, are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. If

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

circumstances require a long-lived asset to be tested for possible impairment, FMOLHS first compares the undiscounted future cash flows expected to be generated by the assets to its carrying value. If the carrying amount of the long-lived asset is not recoverable on an undiscounted cash flow basis, an impairment charge is recognized to the extent the carrying amount of the asset exceeds its fair value. Fair value is determined through various valuation techniques including discounted cash flow models, quoted market values, and third-party appraisals, as considered necessary.

Assets to be disposed of are separately presented in the accompanying consolidated balance sheets and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. The assets and liabilities of a disposal group classified as held-for-sale are presented separately in the asset and liability sections of the accompanying consolidated balance sheets.

(m) *Estimated Workers' Compensation, Professional Liability, and Employee Health Claims*

The provisions for estimated workers' compensation, professional liability, and employee health claims include estimates of the ultimate costs for both reported claims and claims incurred but not reported. These estimates incorporate FMOLHS's past experience, as well as other considerations, including the nature of claims, industry data, relevant trends, and/or the use of actuarial information.

(n) *Consolidated Statements of Operations*

Transactions deemed to be ongoing, major, or central to the provision of healthcare services are reported as operating revenues and expenses. Peripheral or incidental transactions are reported as nonoperating gains and losses. Investment return, consisting of dividends and interest earned on investments, as well as realized and unrealized gains and losses on the investment portfolio, medical office building rental income, the change in value of interest rate swap agreement, and gains and losses on asset disposals are reported as nonoperating gains or losses.

The consolidated statements of operations include unrestricted revenues, gains, and other support in excess of expenses and losses, which is an indicator of financial performance. Changes in unrestricted net assets that are excluded from unrestricted revenues, gains, and other support in excess of expenses and losses include permanent transfers of assets to and from affiliates for other than goods and services, pension-related changes other than net periodic pension cost, and contributions of long-lived assets (including assets acquired using contributions that by donor restriction were to be used for the purpose of acquiring such assets).

(o) *Net Patient Service Revenue*

Net patient service revenue is recognized as services are performed and is reported at the estimated net realizable amounts from patients, third-party payors, and others for services rendered, including estimated retroactive adjustments under reimbursement agreements with third-party payors.

Retroactively calculated contractual adjustments arising under reimbursement agreements with third-party payors are accrued on an estimated basis in the period the related services are rendered and are adjusted as final settlements are determined.

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

(p) Charity Care

The FMOLHS Affiliates provide care to patients who meet certain criteria under their charity care policies without charge or at amounts less than its established rates. Because the FMOLHS Affiliates do not pursue collection of amounts determined to qualify as charity care, such amounts are not reported as revenue.

The FMOLHS Affiliates maintain records to identify and monitor the level of charges forgone that are associated with the charity care they provide. Charges forgone, based on established rates, totaled approximately \$30,305 and \$32,084 for the years ended June 30, 2012 and 2011, respectively.

The FMOLHS Affiliates do not include charity care in net patient service revenue. The cost of charity care provided in 2012 and 2011 approximated \$11,216 and \$12,140, respectively. FMOLHS Affiliates estimated these costs by calculating a ratio of cost to gross charges and then multiplying that ratio by the gross charity charges associated with providing care to charity patients.

(q) Electronic Health Record Incentive Program

The Centers for Medicare & Medicaid Services (CMS) have implemented provisions of the American Recovery and Reinvestment Act of 2009 that provide incentive payments beginning in 2011 for the meaningful use of certified electronic health record (EHR) technology. CMS has defined meaningful use as meeting certain objectives and clinical quality measures based on current and updated technology capabilities over predetermined reporting periods as established by CMS. The Medicare EHR incentive program provides annual incentive payments to eligible professionals, eligible hospitals, and critical access hospitals, as defined, that are meaningful users of certified EHR technology. The Medicaid EHR incentive program provides annual incentive payments to eligible professionals and hospitals for efforts to adopt, implement, and meaningfully use certified EHR technology. FMOLHS utilizes a contingency accounting model to recognize EHR incentive revenues. FMOLHS records EHR incentive revenue when FMOLHS has actually complied with the meaningful use criteria for a full reporting period and when all uncertainties and contingencies are resolved prior to the recognition of income. In fiscal 2012, FMOLHS recorded EHR incentive revenues of \$15,372 comprised of \$8,361 of Medicare revenues and \$7,011 of Medicaid revenues. EHR incentive revenues are included in net patient service revenue in the accompanying consolidated statements of operations. There were no EHR incentive receivables from Medicare and Medicaid at June 30, 2012. FMOLHS did not recognize any EHR incentive revenues for the year ended June 30, 2011.

(r) Income Taxes

FMOLHS and the FMOLHS Affiliates are exempt from federal income taxes under Section 501(a) of the Internal Revenue Code (IRC) as organizations described in IRC Section 501(c)(3). Certain of the FMOLHS Affiliates' subsidiaries are subject to federal and state income taxes, provisions for which have been reflected in the accompanying consolidated financial statements. The amounts of such provisions are not material.

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

FMOLHS recognizes the effect of income tax positions only if those positions are more likely than not of being sustained. Recognized income tax positions are measured at the largest amount that is greater than 50% likely of being realized. Changes in recognition or measurement are reflected in the period in which the change in judgment occurs. No reserves for uncertain tax positions have been recorded.

(s) *Asset Retirement Obligations*

FMOLHS recognizes the fair value of a liability for legal obligations associated with asset retirements in the period in which it is incurred, if a reasonable estimate of the fair value of the obligation can be made. When the liability is initially recorded, FMOLHS capitalizes the cost of the asset retirement obligation by increasing the carrying amount of the related long-lived asset. Over time, the liability is accreted to its present value each period, and the capitalized cost associated with the retirement obligation is depreciated over the useful life of the related asset. Upon settlement of the obligation, any difference between the cost to settle the asset retirement obligation and the liability recorded is recognized as a gain or loss in the consolidated statements of operations.

(t) *Fair Value Measurements*

FMOLHS applies Accounting Standards Codification (ASC) Topic 820, *Fair Value Measurements and Disclosures*, which defines fair value, establishes an enhanced framework for measuring fair value, and expands disclosures about fair value measurements, including those required for certain investments in funds that do not have readily determinable fair values including private equity investments, hedge funds, real estate, and other funds. ASC Topic 820 permits, as a practical expedient, the estimation of the fair value of investments in investment companies for which the investment does not have a readily determinable fair value using net asset value per share or its equivalent. Net asset value, in many instances, may not equal fair value that would be calculated pursuant to other related requirements of ASC Topic 820.

FMOLHS also follows FASB ASU 2010-06, *Improving Disclosures about Fair Value Measurements*, which amended Topic 820. ASU 2010-06 requires that FMOLHS provide additional enhanced disclosures related to its fair value measurements.

FMOLHS utilizes valuation techniques that maximize the use of observable inputs and minimize the use of unobservable inputs to the extent possible. FMOLHS determines fair value based on assumptions that market participants would use in pricing an asset or liability in the principal or most advantageous market. When considering market participant assumptions in fair value measurements, the following fair value hierarchy distinguishes between observable and unobservable inputs, which are categorized in one of the following levels:

- Level 1 Inputs: Unadjusted quoted prices in active markets for identical assets or liabilities accessible to the reporting entity at the measurement date.

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

- Level 2 Inputs: Other than quoted prices included in Level 1 inputs that are observable for the asset or liability, either directly or indirectly, for substantially the full term of the asset or liability.
- Level 3 Inputs: Unobservable inputs for the asset or liability used to measure fair value to the extent that observable inputs are not available, thereby allowing for situations in which there is little, if any, market activity for the asset or liability at measurement date

(u) Fair Value Option

ASC SubTopic 825-10, *Financial Instruments – Overall* gives FMOLHS the irrevocable option to report most financial assets and financial liabilities at fair value on an instrument-by-instrument basis, with changes in fair value reported in earnings. FMOLHS has not elected to apply the fair value option to any assets or liabilities.

(v) New Accounting Pronouncements

Recently Adopted

The FASB issued ASU 2010-23, *Health Care Entities (Topic 954) Measuring Charity Care for Disclosure* in August 2010. ASU 2010-23 amends ASC SubTopic 954-605, *Health Care Entities-Revenue Recognition*, to require that cost be used as the measurement basis for charity care disclosure purposes. The method used to estimate such costs as well as any funds received to offset or subsidize charity services provided should also be disclosed. FMOLHS's adoption of this ASU in fiscal year 2012 did not have any impact on its consolidated financial statements.

The FASB issued ASU 2010-24, *Health Care Entities (Topic 954) Presentation of Insurance Claims and Related Insurance Recoveries* in August 2010. ASU 2010-24 amends ASC SubTopic 954-450, *Health Care Entities-Contingencies*, to clarify that a healthcare entity should not net insurance recoveries against a related liability and the claim liability should be determined without consideration of insurance recoveries. The FMOLHS's adoption of this ASU in fiscal year 2012 did not have a significant impact on its consolidated financial statements.

Recently Issued

In July 2011, the FASB issued ASU 2011-07, *Health Care Entities Presentation and Disclosure of Patient Service Revenue, Provision for Bad Debts, and the Allowance for Doubtful Accounts for Certain Health Care Entities*. This ASU will change FMOLHS presentation of provision for uncollectible accounts in the consolidated statements of operations from operating expenses to a deduction from net patient service revenue. It also expands disclosures regarding policies for recognizing revenue, assessing contra revenue line items, and activity in the allowance for uncollectible accounts. The ASU is effective for FMOLHS's fiscal year 2013.

In May 2011, the FASB issued ASU 2011-04, *Fair Value Measurement (Topic 820) Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in US GAAP and IFRS*. The new standard does not extend the use of fair value but, rather, provides guidance about how fair

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

value should be applied where it already is required or permitted under IFRS or U S GAAP. For U S. GAAP, most of the changes are clarifications of existing guidance or wording changes to align with IFRS. A nonpublic entity is required to apply the ASU prospectively for annual periods beginning after December 15, 2011. FMOLHS expects that the adoption of ASU 2011-04 in 2013 is not expected to have a material impact on its consolidated financial statements.

(w) Current Economic Environment

In light of the current sluggish recovery of the U.S. economy, FMOLHS monitors economic conditions closely, both with respect to potential impacts on the healthcare provider industry and from a more general business perspective. Management recognizes that economic conditions may continue to impact FMOLHS in a number of ways, including (but not limited to) uncertainties associated with U.S. financial system reform and rising self-pay patient volumes and corresponding increases in uncompensated care.

Additionally, the general healthcare industry environment is increasingly uncertain, especially with respect to the impacts of the federal healthcare reform legislation, which was passed in the spring of 2010. Potential impacts of ongoing healthcare industry transformation include, but are not limited to:

- Significant (and potentially unprecedented) capital investment in healthcare information technology (HCIT),
- Continuing volatility in the state and federal government reimbursement programs,
- Lack of clarity related to the health benefit exchange framework mandated by reform legislation, including important open questions regarding exchange reimbursement levels, changes in combined state/federal disproportionate share payments, and impact on the healthcare "demand curve" as the previously uninsured enter the insurance system,
- Effective management of multiple major regulatory mandates, including achievement of meaningful use of HCIT and the transition to ICD-10, and
- Significant potential business model changes throughout the healthcare ecosystem, including within the healthcare commercial payor industry.

The business of healthcare in the current economic, legislative, and regulatory environment is volatile. Any of the above factors, along with others both currently in existence and which may or may not arise in the future, could have a material adverse impact on FMOLHS's financial position and operating results.

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

(2) Short-Term Investments and Assets Limited as to Use

Short-term investments consist of the following

	<u>2012</u>	<u>2011</u>
Asset category		
Cash	\$ 640	1,108
Equity securities		
U S companies	4,361	2,656
International companies	1,689	2,297
Real assets	1,160	1,716
Fixed income securities		
U S government guaranteed	66	43
U S. agency	383	543
Corporate	670	2,275
Municipal	28	155
Other	1,876	2,838
Emerging markets	722	545
Alternative asset funds		
Hedge funds	4,149	5,141
Private equity funds	1,794	1,937
Total	<u>\$ 17,538</u>	<u>21,254</u>

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

The composition of assets limited as to use at June 30, 2012 and 2011 is as follows.

	2012				
	Board- designated for capital	Trusted bond funds	Self- insurance trust funds	Other	Total
Asset category					
Cash	\$ 32,846	23,997	815	2,725	60,383
Equity securities					
U S companies	92,345	—	2,917	4,652	99,914
International companies	70,598	—	—	414	71,012
Real assets	48,469	—	—	—	48,469
Fixed income securities					
U S government guaranteed	2,758	—	3,228	—	5,986
U S agency	15,982	—	17,176	—	33,158
Corporate	27,984	—	—	1,834	29,818
Municipal	1,185	—	—	—	1,185
Other	64,195	—	—	1,031	65,226
Emerging markets	30,163	—	—	—	30,163
Alternative asset funds					
Hedge funds	173,366	—	—	—	173,366
Private equity funds	74,968	—	—	—	74,968
Accrued interest	367	—	—	—	367
	635,226	23,997	24,136	10,656	694,015
Less amounts classified as current assets	913	23,997	—	593	25,503
Noncurrent portion	\$ 634,313	—	24,136	10,063	668,512

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

	2011				
	Board- designated for capital	Trusted bond funds	Self- insurance trust funds	Other	Total
Asset category					
Cash	\$ 88,676	25,351	2,156	3,052	119,235
Equity securities					
U S companies	87,941	—	3,124	4,437	95,502
International companies	76,118	—	—	149	76,267
Real assets	56,862	—	—	—	56,862
Fixed income securities					
U S government guaranteed	1,411	—	4,682	—	6,093
U S agency	11,145	—	10,734	325	22,204
Corporate	29,931	—	—	1,519	31,450
Municipal	1,347	—	—	—	1,347
Other	58,223	—	—	1,264	59,487
Emerging markets	18,065	—	—	—	18,065
Alternative asset funds					
Hedge funds	170,336	—	—	103	170,439
Private equity funds	64,189	—	—	—	64,189
Accrued interest	403	—	3	—	406
	664,647	25,351	20,699	10,849	721,546
Less amounts classified as current assets	6,946	23,234	—	581	30,761
Noncurrent portion	\$ 657,701	2,117	20,699	10,268	690,785

(a) Board-Designated for Capital

In accordance with Board approval, the FMOLHS Affiliates have designated assets to fund future capital acquisitions and capital improvements

The FMOLHS Affiliates invest their board-designated for capital funds together within FMOLHS in a capital reserve investment fund held in a JP Morgan Chase Bank custodial account. Through usage of unitized accounting, these investments are segregated for each FMOLHS Affiliate. Investments held as board-designated for capital are managed by several money managers, which focus on different investment strategies and provide diversity to the investments.

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

(b) Alternative Assets

Alternative assets (included in short-term investments and assets limited as to use) include limited partnerships and offshore investment funds. These funds invest in certain types of financial instruments, including, among others, futures and forward contracts, options, and securities sold not yet purchased, intended to hedge against changes in the market value of investments. These financial instruments, which involve varying degrees of risk, may result in loss due to changes in the market (market risk). Alternative assets by strategy type are as follows:

	<u>2012</u>	<u>2011</u>
Alternative assets		
Hedge funds	\$ 177,515	175,580
Private equity	<u>76,762</u>	<u>66,126</u>
Total alternative assets	<u>\$ 254,277</u>	<u>241,706</u>

At June 30, 2012, FMOLHS's remaining outstanding commitments to private equity interests totaled \$37,502. The projected capital call amounts for the next five fiscal years and thereafter are summarized in the table below:

	<u>Projected capital calls</u>
Fiscal year	
2012	\$ 17,960
2013	14,365
2014	4,021
2015	822
2016	265
Thereafter	<u>69</u>
	<u>\$ 37,502</u>

Private equity interests have 10-year terms, with extensions of 1 to 4 years. As of June 30, 2012, the average remaining life of the private equity interests is approximately 8.1 years.

At June 30, 2012 and 2011, FMOLHS had hedge fund investments of \$177,515 and \$175,580, respectively, which were restricted from redemption for lock-up periods. Some of the hedge fund investments with redemption restrictions allow early redemption for specified fees. The terms and conditions upon which an investor may redeem an investment vary, usually requiring 30 to 180 days notice after the initial lock-up period.

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

Based upon the terms and conditions in effect at June 30, 2012, FMOLHS's hedge fund investments can be redeemed or sold as follows

	<u>Amount</u>
Fiscal year	
2013	\$ 161,126
2014	8,862
2015	—
2016	—
2017	—
2018 – 2022	—
Thereafter	<u>7,527</u>
Total	<u>\$ 177,515</u>

(c) *Trusted Bond Funds*

Certain trusted bond funds have been established in accordance with the requirements of indentures related to various bond obligations. The consolidated trusted bond funds as of June 30, 2012 and 2011 consist of the following categories

	<u>2012</u>	<u>2011</u>
Construction funds	\$ —	1,755
Principal and interest funds	<u>23,997</u>	<u>23,596</u>
	23,997	25,351
Less amounts classified as current	<u>23,997</u>	<u>23,234</u>
Noncurrent portion	<u>\$ —</u>	<u>2,117</u>

The above funds were established in accordance with related indentures to secure the payment of principal and interest on the related obligations, and to pay or reimburse the FMOLHS Affiliates for payment of the costs of the acquisition, construction, and installation of certain extensions and improvements to their facilities. Amounts classified as current represent funds deposited to pay current costs of construction projects and to pay related debt service costs classified as current liabilities. Information regarding FMOLHS's debt obligations is included in note 9.

(d) *Self-insurance Trust Funds*

The self-insurance trust funds represent amounts designated to pay certain self-insured losses (see note 18).

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

(e) Other

Other assets limited at to use as of June 30, 2012 and 2011 consist of the following

	<u>2012</u>	<u>2011</u>
Scholarships – limited by donor	\$ 184	217
Healthcare services – limited by donor	9,167	9,361
Resident deposits	141	104
Escrow, security deposits, and surplus cash	260	258
Capital improvement – limited by grantor agency	904	909
	<u>10,656</u>	<u>10,849</u>
Less amounts classified as current	593	581
	<u>\$ 10,063</u>	<u>10,268</u>

All investments are considered “trading” for accounting purposes. All unrestricted investment income, including both realized and unrealized gains and losses, is included in the reported total of unrestricted revenues, gains, and other support in excess of expenses and losses. The following schedule for the years ended June 30, 2012 and 2011 summarizes the investment return and its classification in the consolidated statements of operations.

	<u>Unrestricted</u>	<u>Temporarily restricted</u>	<u>Total</u>
2012			
Dividends and interest, net of expenses of \$2,088	\$ 5,790	1	5,791
Realized and unrealized gains (losses), net	(11,122)	15	(11,107)
Investment return	<u>\$ (5,332)</u>	<u>16</u>	<u>(5,316)</u>
2011			
Dividends and interest, net of expenses of \$2,299	\$ 4,367	1	4,368
Realized and unrealized gains, net	114,903	35	114,938
Investment return	<u>\$ 119,270</u>	<u>36</u>	<u>119,306</u>

Investments, in general, are exposed to various risks such as interest rate, credit, and overall market volatility. As such, it is reasonably possible that changes in the values of investments will occur in the near term and that such changes could materially affect the amounts reported in the consolidated balance sheets, statements of operations, and statements of changes in net assets.

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

(3) Other Current Assets

The composition of other current assets at June 30, 2012 and 2011 follows

	<u>2012</u>	<u>2011</u>
Due from third-party payors	\$ —	730
Other receivables	13,005	13,028
Inventories	23,007	22,820
Prepaid expenses and other current assets	20,199	21,641
Assets limited as to use required for current liabilities	25,503	30,761
	<u>\$ 81,714</u>	<u>88,980</u>

(4) Property and Equipment

A summary of property and equipment as of June 30, 2012 and 2011 is as follows

	<u>2012</u>	<u>2011</u>	<u>Estimated useful lives</u>
Land	\$ 123,195	120,319	—
Land improvements	15,520	15,409	2 – 40 years
Buildings and building improvements	931,013	831,495	5 – 50 years
Fixed equipment	109,329	110,872	3 – 50 years
Movable equipment	535,280	536,745	3 – 25 years
Leasehold improvements	7,188	7,586	5 – 15 years
Building and building improvements held for lease	3,543	3,543	2 – 22 years
Construction in progress	92,146	29,306	
	<u>1,817,214</u>	<u>1,655,275</u>	
Less accumulated depreciation	817,952	710,983	
	<u>\$ 999,262</u>	<u>944,292</u>	

At June 30, 2012, the FMOLHS Affiliates were obligated under purchase commitments of \$177,864 relating to the completion of various construction projects and purchases of equipment. Approximately \$4,374 and \$6,606 related to such projects and other property additions are included in accounts payable at June 30, 2012 and 2011, respectively.

In 2011, Lourdes placed a new hospital and related facilities in service. In June 2011, Lourdes reclassified depreciated assets related to its former operating facility and the surrounding medical office buildings and parking towers as assets held-for-sale on the consolidated financial statements. At June 30, 2011, Lourdes

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

had \$15,055 classified as held-for-sale. During 2012, Lourdes reclassified these assets from held for sale as they no longer met requirements for held for sale accounting.

(5) Other Assets

The composition of other assets at June 30, 2012 and 2011 follows:

	<u>2012</u>	<u>2011</u>
Unamortized bond issuance costs, net of accumulated amortization	\$ 6,839	7,262
Investments in equity investees	64,956	64,034
Cost in excess of net assets acquired	13,236	13,236
Fair value of interest rate swap agreements	5,573	8,478
Other	22,157	13,053
	<u>\$ 112,761</u>	<u>106,063</u>

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

(6) Investment in Equity Investees

A summary of the FMOLHS Affiliates investment in equity investees at June 30, 2012 and 2011 included in other assets in the consolidated balance sheets, and its income from equity investees for the years ended June 30, 2012 and 2011 are as follows

	<u>Ownership interest</u>	<u>Investment in investees</u>	<u>Equity income (loss) of investees</u>
2012			
Convenient Care, LLC	50%	\$ 1,650	197
Capital Area Shared Service Organization	48	341	(126)
Surgical Specialty Center of Baton Rouge, LLC	49	24,702	4,599
Regional Eye Surgery Center	14	164	246
Baton Rouge Physical Therapy-Lake	29	466	139
Baton Rouge Physical Therapy-STE	4	57	17
Perkins Plaza ASC	46	620	128
P&S Surgery Center, LLC	50	12,783	2,091
Northeast Louisiana Cancer Institute, LLC	50	2,920	674
Northeast Louisiana Physician Hospital Organization	25	169	(13)
Louisiana Home Care of Monroe, LLC	33	85	23
Lourdes After Hours, LLC	50	514	40
Louisiana Health Care Group, LLC	33	330	264
Park Place Surgery Center	45	17,074	3,858
Capital Area Shared Services	17	120	(50)
Mary Bird Perkins Cancer Center	35	2,961	(54)
		<u>\$ 64,956</u>	<u>12,033</u>

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

	<u>Ownership interest</u>	<u>Investment in investees</u>	<u>Equity income (loss) of investees</u>
2011			
Convenient Care, LLC	50%	\$ 2,079	443
Capital Area Shared Services	48	466	(15)
Regional Eye Surgery Center	14	193	229
Baton Rouge Physical Therapy-Lake	29	468	170
Baton Rouge Physical Therapy-STE	4	56	21
Surgical Specialty Center of Baton Rouge, LLC	49	24,028	3,186
Perkins Plaza ASC	46	721	293
P&S Surgery Center, LLC	50	12,368	2,039
Northeast Louisiana Cancer Institute, LLC	50	3,081	695
Northeast Louisiana Physician Hospital Organization	25	182	26
St. Francis Pediatric After Hours Clinic, LLC	50	124	26
Louisiana Home Care of Monroe, LLC	33	97	46
Lourdes After Hours, LLC	50	473	142
Louisiana Health Care Group, LLC	33	99	70
Park Place Surgery Center	45	16,334	3,500
Capital Area Shared Services	17	170	—
Mary Bird Perkins Cancer Center	35	3,095	80
		<u>\$ 64,034</u>	<u>10,951</u>

(7) Lines of Credit

At June 30, 2012, FMOLHS affiliates had various unsecured working capital lines of credit with banks in the aggregate amount of \$20,500, bearing interest at variable rates expiring at various dates through December 2012. Outstanding amounts at June 30, 2012 and 2011 were \$5,996 and \$4,650, respectively. FMOLHS affiliates expect to renew the lines of credit at expiration under substantially the same terms and conditions.

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

(8) Other Current Liabilities

The composition of other current liabilities at June 30, 2012 and 2011 follows

	<u>2012</u>	<u>2011</u>
Accrued salaries and related expenses	\$ 61,856	58,466
Accrued interest	9,730	9,899
Accrued expenses and other current liabilities	97,614	85,126
	<u>\$ 169,200</u>	<u>153,491</u>

(9) Long-Term Debt

A summary of long-term debt at June 30, 2012 and 2011 is as follows

	<u>2012</u>	<u>2011</u>
Obligated Group bonds		
Louisiana Public Facilities Authority Hospital Revenue and Refunding Bonds Series 1998A, \$72,560 tax-exempt bonds, due in varying installments through 2026 with interest fixed at rates ranging from 5 50% to 5 75%	\$ 49,505	57,620
Louisiana Public Facilities Authority Hospital Revenue and Refunding Bonds Series 1998B, \$31,050 tax-exempt bonds, due in varying installments through fiscal year 2017, with interest fixed at rates ranging from 3 375% to 5 000%, respectively), due in varying installments through 2017	22,800	27,050
Louisiana Public Facilities Authority Hospital Bonds Series 2005A, \$80,000 tax-exempt bonds, due in varying installments from 2032 through 2037, with interest fixed at rates ranging from 5 00% to 5 25%	80,000	80,000
Louisiana Public Facilities Authority Hospital Bonds Series 2005B, \$50,000 tax-exempt bonds, due in varying installments from fiscal year 2014 through 2031, which bear interest at a variable rate (0 17% at June 30, 2012)	50,000	50,000
Louisiana Public Facilities Authority Hospital Bonds Series 2005C, \$50,000 tax-exempt bonds, due in varying installments from fiscal year 2014 through 2031, with interest fixed at a rates ranging from 4 00% to 6 75%	50,000	50,000
Louisiana Public Facilities Authority Hospital Bonds Series 2005D, \$88,325 bonds due in varying installments through 2029, which bear interest at a variable rate (0 17% at June 30, 2012)	79,450	82,526

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

	<u>2012</u>	<u>2011</u>
Louisiana Public Facilities Authority Hospital Bonds Series 2008A, \$47,185 bonds; due in varying installments through fiscal year 2026, which bear interest at a variable rate (0 20% at June 30, 2012)	\$ 46,480	46,650
Louisiana Public Facilities Authority Hospital Revenue Bonds Series 2009A, \$125,000 bonds; due in varying installments from fiscal year 2029 through 2040, with interest fixed at rates ranging from 6 63% to 6 75%	<u>125,000</u>	<u>125,000</u>
	503,235	518,846
Add unamortized premium	<u>334</u>	<u>411</u>
Total Obligated Group bonds	503,569	519,257
Other debt – Our Lady of the Lake Regional Medical Center		
Mortgage payable in monthly installments of \$23, including interest at 9 00%, through May 1, 2033, secured by land, building and equipment	2,569	2,609
Mortgage payable in monthly installments of \$33, including interest at 6 80%, through December 2012, secured by land, building and equipment	2,950	3,209
Mortgage payable in monthly installments of \$29, including interest at 6 90% through April 2016 with a lump sum due at this time, secured by land and building	3,060	3,167
Other debt – Our Lady of Lourdes Regional Medical Center		
Note payable, payable upon demand, including interest at 5 50%, maturing April 2013, secured by equipment, inventory and accounts receivable	435	938
Note payable, due in monthly installments of \$7, including interest at 5 75%, through January 2013 secured by 1 1 acres of property	59	158
Note payable, payable upon demand, including interest at 3 25% maturing October 2016, secured by equipment	2,787	—
Note payable, payable upon demand, including interest at 3 25% maturing April 2016, secured by equipment	705	890
Note payable, payable upon demand, including interest at 4 42%, maturing December 2014, secured by equipment	1,080	1,479

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

	<u>2012</u>	<u>2011</u>
Other debt – St. Elizabeth		
Note payable in monthly installments of \$51, including interest at 5.15%, through October 15, secured by land, building and equipment	\$ 4,203	4,587
Total long-term debt for FMOLHS	521,417	536,294
Less current installments of long-term debt	19,027	17,585
	<u>\$ 502,390</u>	<u>518,709</u>

FMOLHS and its affiliates participate in an Obligated Group Master Trust Indenture whereby the obligated issuers have agreed to be jointly and severally liable for timely payments due and for the performance and observance of all covenants and agreements pursuant to the trust indenture. FMOLHS directs the proceeds of the borrowed funds to the particular affiliate benefiting therefrom and separate escrow funds are maintained by the trustee for each of the affiliates to support each affiliate's allocated portion of the bonds (see note 2). The total debt subject to the Obligated Group guarantee and Master Trust Indenture amounted to \$503,569 and \$519,257 as of June 30, 2012 and 2011, respectively.

The Master Trust Indenture covering the bond issues contains numerous covenants typical of such agreements, including a liquidity ratio, debt service coverage ratio, and leverage ratio. In addition, the Obligated Group members are subject to restrictions on maintenance of revenue, incurrence of additional debt, disposition of assets, maintenance of insurance, and other restrictions. Obligations of the Obligated Group under the Master Trust Indenture are general obligations secured by the full faith and credit of the Obligated Group. None of the bonds is secured by a mortgage on, or security interest in, any real or personal property of FMOLHS or its affiliates.

In 2005, FMOLHS completed a system-wide refinancing for the purposes of advance refunding certain 1998A and 1998C bonds and providing additional capital by issuing four series of revenue bonds. The following bond series were issued by the Louisiana Public Facilities Authority (the Authority): \$80,000 fixed rate Revenue Bonds (Series 2005A), \$100,000 variable rate Revenue Bonds (Series 2005B and 2005C in the amounts of \$50,000 each), and \$89,325 in variable rate Revenue and Refunding bonds (Series 2005D). The variable rate bonds were issued as auction rate securities. The four bond issues total \$269,325, of which approximately \$83,000 represents refunding of existing bonds and the remainder of approximately \$186,000 was designated for capital improvements, including facility modifications and additions and new equipment acquisitions.

In May 2008, FMOLHS tendered its 2005B and 2005C auction rate bonds and reissued 2005B and 2005C bonds at weekly variable interest modes. In July and August 2008, the 2005D and 1998B auction rate bonds were tendered by FMOLHS and reissued at daily variable interest modes. In August 2008, the 2008A bonds, which were preapproved by the Authority, were issued by FMOLHS. These bonds, issued in

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

the amount of \$47,185, bear interest at a variable rate based upon a weekly index rate and are due in 2025. These bonds refunded \$42,735 of the 1998A bonds and \$3,225 of the 1998C bonds.

In 2009, FMOLHS completed a systemwide issuance of \$125,000 of Hospital Revenue Bonds Series 2009 (the 2009 Series). The proceeds for the 2009 Series were used for (i) acquiring, constructing, and equipping a replacement hospital for Lourdes, (ii) acquiring, constructing, and equipping improvement and renovations to the existing Lake facilities, to accommodate modern demands for space and utility and building a satellite outpatient facility in Livingston Parish, Louisiana, and (iii) paying the costs of issuance of the bonds.

In addition to the issuance of the 2009 Series, FMOLHS (i) converted the interest rate from the daily variable interest modes to a fixed rate on the Series 1998B and (ii) converted the interest rate from the weekly variable interest modes to a fixed rate on the Series 2005C.

FMOLHS and FMOLHS Affiliates made cash payments for interest of \$26,203 and \$25,424 during the years ended June 30, 2012 and 2011, respectively.

Aggregate maturities of long-term debt at June 30, 2012 follow:

Year ending June 30	
2013	\$ 19,027
2014	14,426
2015	14,335
2016	19,722
2017	13,908
Thereafter	<u>439,665</u>
	<u>\$ 521,083</u>

In fiscal 2013, FMOLHS anticipates borrowing approximately \$142,825 through the Authority to refinance existing bonds totaling approximately \$57,175. The new bonds will fund capital projects at the Lake and refinance Series 2005C bonds. There can be no assurance that the anticipated borrowing as described will occur.

(10) Interest Rate Swaps

FMOLHS uses interest rate related derivative instruments to manage its exposure related to changes in interest rates on its variable rate debt instruments. FMOLHS does not enter into derivative instruments for any purpose other than cash flow hedging. FMOLHS does not speculate using derivative instruments.

By using derivative financial instruments to hedge exposures to changes in interest rates, FMOLHS exposes itself to credit risk and market risk. Credit risk is the failure of the counterparty to perform under the terms of the derivative contract. When the fair value of a derivative contract is positive, the counterparty owes FMOLHS, which creates credit risk for FMOLHS. When the fair value of a derivative

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

contract is negative, FMOLHS owes the counterparty, and therefore, FMOLHS is not exposed to the counterparty's credit risk in those circumstances. FMOLHS minimizes counterparty credit risk in derivative instruments by entering into transactions with high-quality counterparties.

Market risk is the adverse effect on the value of a derivative instrument that results from a change in interest rates. Such risk associated with interest rate changes is managed by establishing and monitoring parameters that limit the types and degree of market risk that may be undertaken.

FMOLHS entered into an interest rate swap agreement with Merrill Lynch Capital Services with respect to the 2005D refunding series. Such agreement is intended to reduce the impact of changes in interest rates on the variable rate debt. The swap agreement effectively changes FMOLHS's interest rate exposure on the 2005D variable rate debt to a fixed rate of 3.53%.

In 2005, FMOLHS also obtained preapproval from the Louisiana Public Facilities Authority for the issuance of revenue refunding bonds in 2008 to advance refund the approximately \$48,000 of 1998A and 1998C bonds. In 2005, FMOLHS entered into a forward starting interest rate swap agreement with Goldman Sachs Capital Markets to effectively change FMOLHS's interest rate exposure on the 2008 bonds once issued from a variable rate to a fixed rate of 3.66%.

In June 2007, FMOLHS entered into two Constant Maturity Swaps (CMS) with Merrill Lynch. Under these swap agreements, FMOLHS receives variable rate payments based on the ten-year International Swaps and Derivatives Association Inc. (ISDA) swap rate and makes variable rate payments based on one-month LIBOR. The total notional amount of the first swap is \$88,325, with an effective date of July 1, 2008, and the total notional amount of the second swap is \$49,075, with an effective date of May 29, 2008.

The interest rate swap agreements are not afforded hedge accounting treatment in the consolidated financial statements and are marked to fair value through the consolidated statements of operations. The net unrealized gain (loss) on the interest rate swaps for the years ended June 30, 2012 and 2011 was \$(14,119) and \$4,676, respectively, and is included in nonoperating gains in the accompanying consolidated statements of operations.

The following is a summary of the contracts outstanding at June 30, 2012 and 2011 and are recorded, as applicable, in either other assets or other long-term liabilities:

June 30, 2012						
Related bond issuance	Notional amount	Maturity date	Average rate paid	Average rate received	(Decrease) increase in interest expense	Swap fair value
2005D	\$ 79,450	7/1/2028	3.53%	0.17%	\$ 2,669	(15,482)
2005D	79,450	7/1/2028	0.17	1.20	(823)	3,318
2008A	48,375	7/1/2025	3.66	0.17	1,687	(10,219)
2008A	48,375	7/1/2025	0.17	1.20	(500)	2,255

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

June 30, 2011						
Related bond issuance	Notional amount	Maturity date	Average rate paid	Average rate received	(Decrease) increase in interest expense	Swap fair value
2005D	\$ 82,525	7/1/2028	3.53%	0.18%	\$ 2,763	(8,589)
2005D	82,525	7/1/2028	0.18	1.84	(1,370)	5,147
2008A	48,625	7/1/2025	3.66	0.18	1,690	(5,898)
2008A	48,625	7/1/2025	0.18	1.84	(807)	3,331

(11) Temporarily and Permanently Restricted Net Assets

Temporarily restricted net assets restricted by time and purpose at June 30, 2012 and 2011 are available for the following purposes

	2012	2011
Healthcare services	\$ 8,525	7,893
Elderly housing	9,428	8,039
Building and equipment acquisitions	116	116
Educational services	2,612	2,392
Other	121	169
	\$ 20,802	18,609

Permanently restricted net assets at June 30, 2012 and 2011 totaled \$5,510 and \$5,516, respectively, the income from which is restricted for educational services

Net assets released from restrictions for the years ended June 30, 2012 and 2011 are as follows

	2012	2011
Healthcare services	\$ 2,474	4,785
Elderly housing	133	125
Building and equipment acquisitions	—	16
Educational services and other	306	563
	\$ 2,913	5,489

(12) Net Patient Service Revenue

The FMOLHS Affiliates have agreements with governmental and other third-party payors that provide for reimbursement to the FMOLHS Affiliates at amounts different from their established rates. Contractual adjustments under third-party reimbursement programs represent the difference between billings at

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

established rates for services and amounts reimbursed by third-party payors. A summary of the basis of reimbursement with major third-party payors follows:

(a) Medicare

Substantially all acute care services rendered to Medicare program beneficiaries are paid at prospectively determined rates per discharge. These rates vary according to a patient classification system that is based on clinical, diagnostic, and other factors. Certain types of exempt services and other defined payments related to Medicare beneficiaries are paid based on cost reimbursement or other retroactive determination methodologies. The FMOLHS Affiliates are paid for retroactively determined items at tentative rates with final settlement determined after submission of annual cost reports by FMOLHS Affiliates and audits by the Medicare fiscal intermediary. The FMOLHS Affiliates' Medicare cost reports have been audited by the Medicare fiscal intermediary through varying years ranging from June 30, 2004 to June 30, 2007. Revenue from the Medicare program accounted for approximately 34% and 26% of FMOLHS's net patient service revenue for the years ended June 30, 2012 and 2011, respectively.

(b) Medicaid

Inpatient services rendered to Medicaid program beneficiaries are paid at prospectively determined per diem rates. These rates vary according to a hospital classification system that is based on bed size, teaching status, and other factors. Additional outlier payments are made for neonatal intensive care patients with extended lengths of stay. Outpatient services rendered to Medicaid program beneficiaries are reimbursed based upon a cost reimbursement methodology. The FMOLHS Affiliates are paid at a tentative rate with final settlement determined after submission of annual cost reports by FMOLHS Affiliates and audits by the Medicaid fiscal intermediary. The FMOLHS Affiliates' Medicaid cost reports have been audited by the Medicaid fiscal intermediary through varying years ranging from June 30, 2004 to June 30, 2009. Revenue from the Medicaid program accounted for approximately 6% of FMOLHS's net patient service revenue for both the years ended June 30, 2012 and 2011, respectively.

(c) Blue Cross

Inpatient services rendered to Blue Cross subscribers are paid at prospectively determined per diem rates. Outpatient services are paid based on a fee schedule. Revenue from the Blue Cross program accounted for approximately 28% and 22% of FMOLHS's net patient service revenue for the years ended June 30, 2012 and 2011, respectively.

(d) Certain Commercial Insurance Carriers, Health Maintenance Organizations, and Preferred Provider Organizations

Payment methodologies under these agreements include prospectively determined rates per discharge, discounts from established charges, prospectively determined per diem rates, and fee schedules.

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

The FMOLHS Affiliates' net patient service revenue for the years ended June 30, 2012 and 2011 decreased \$8,523 and \$6,485, respectively, due to changes in previously estimated allowances as a result of final settlements, closure on years that are no longer subject to audits, resolution of reviews and investigations, and prior year retroactive adjustments

Presented below is a summary of amounts comprising net patient service revenue for the years ended June 30, 2012 and 2011

	<u>2012</u>	<u>2011</u>
Inpatient revenue	\$ 1,674,709	1,588,224
Outpatient revenue	<u>1,465,374</u>	<u>1,281,776</u>
Gross patient service revenue	3,140,083	2,870,000
Less provisions for contractual and other adjustments	<u>1,820,548</u>	<u>1,507,078</u>
Net patient service revenue	<u>\$ 1,319,535</u>	<u>1,362,922</u>

In the spring of 2010, the Patient Protection and Affordable Care Act and the Health Care and Education Reconciliation Act (collectively, the Health Care Acts) were signed into law by President Obama. The impact of the Health Care Acts is complicated and difficult to predict, but FMOLHS anticipates its reimbursement in the future will be affected by major elements of the Health Care Acts designed to (1) increase insurance coverage, (2) change provider and payor behavior, and (3) encourage alternative delivery models. Many healthcare reform variables remain unknown and are, among other things, dependent on implementation by federal and state governments and reactions by providers, payors, employers, and individuals. FMOLHS continues to monitor developments in healthcare reform and participates actively in contemplating and designing new programs that are encouraged and/or required by the Health Care Acts.

The Health Information Technology for Economic and Clinical Health (HITECH) Act was enacted as part of the American Recovery and Reinvestment Act of 2009 and signed into law in February 2009. In the context of the HITECH Act, FMOLHS must implement a certified Electronic Health Record (EHR) in an effort to promote the adoption and "meaningful use" of health information technology (HIT). The HITECH Act includes significant monetary incentives and payment penalties meant to encourage the adoption of EHR technology. FMOLHS anticipates that its current efforts at implementing an enterprise-wide EHR will enable its compliance with Meaningful Use objectives mandated in the HITECH legislation.

(13) Business and Credit Concentrations

The FMOLHS Affiliates grant credit to their patients, substantially all of whom are local residents. The FMOLHS Affiliates generally do not require collateral or other security in extending credit to patients, however, they routinely obtain assignment of (or are otherwise entitled to receive) patients' benefits payable under their health insurance programs, plans, or policies (e.g., Medicare, Medicaid, Blue Cross, health maintenance organizations, preferred provider arrangements, and commercial insurance policies).

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

The mix of accounts receivable from patients and third-party payors at June 30, 2012 and 2011 is as follows

	<u>2012</u>	<u>2011</u>
Medicare	28%	21%
Medicaid	12	11
Blue Cross	13	15
Self-pay	21	23
Managed care/other	26	30
	<u>100%</u>	<u>100%</u>

(14) Related-Party Transactions

The FMOL Sisters formed the Franciscan Fund (Fund) to support community programs in the operating areas of the FMOLHS hospitals. Each FMOLHS hospital makes contributions to the Fund based on a percentage of earnings determined by the Fund, then can submit grant applications to the Fund to receive moneys back for supporting its community programs. Grant making decisions are made by the FMOL Sisters and no guarantee is provided that each hospital will receive back their specific contribution amounts in the form of a formal grant from the Fund. During 2012 and 2011, FMOLHS made no contributions to the Fund.

During 2011, FMOLHS Affiliates entered into an Operating Agreement with Capital Area Shared Services Organization, a related party. The agreement has an initial term expiring December 2016. The Operating Agreement requires FMOLHS Affiliates to commit to pay certain sublicense fees relating to its use of the services made available to the related third party and to pay certain implementation and system build costs and other costs contemplated under an information system contract for a period through December 31, 2016. At June 30, 2012, FMOLHS has approximately \$6,600 included in other assets related to these agreements.

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

(15) Retirement Plans

(a) Defined Benefit Plans

FMOLHS Affiliates sponsor various defined benefit plans (the Plans). The following table at June 30, 2012 and 2011 sets forth, in the aggregate, the plans' changes in benefit obligations, changes in plan assets, and the funded status of the Plans

	<u>2012</u>	<u>2011</u>
Change in benefit obligation:		
Projected benefit obligation, beginning of year	\$ 588,635	578,008
Service cost	22,064	23,847
Interest cost	33,411	31,394
Actuarial losses	95,491	(35,715)
Merger of Specialty Plan	—	4,191
Benefits paid	(14,943)	(13,090)
Projected benefit obligation, end of year	<u>724,658</u>	<u>588,635</u>
Change in plan assets:		
Fair value of plan assets, beginning of year	412,632	335,853
Actual return on plan assets	(1,652)	55,705
Contributions made	24,030	36,352
Merger of Specialty Plan	—	3,986
Adjustments for prior benefits paid	—	(6,174)
Benefits paid	(14,943)	(13,090)
Fair value of plan assets, end of year	<u>420,067</u>	<u>412,632</u>
Funded status	<u>\$ (304,591)</u>	<u>(176,003)</u>
Amounts recognized in the consolidated balance sheets consist of		
Accrued pension cost	\$ (304,591)	(176,003)
Unrestricted net assets	218,079	93,413
Amounts recognized in unrestricted net assets		
Prior service cost	\$ (1,781)	(2,019)
Net actuarial loss	220,490	95,432
	<u>\$ 218,709</u>	<u>93,413</u>

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

Weighted average assumptions used to determine the projected benefit obligations at June 30, 2012 and 2011 were as follows

	<u>2012</u>	<u>2011</u>
Weighted average discount rate	4.85%	5.75%
Rate of compensation increase	3.50 – 4.25	3.50 – 4.25

Net periodic pension cost for the years ended June 30, 2012 and 2011 includes the following components

	<u>2012</u>	<u>2011</u>
Service cost, benefits earned during the year	\$ 22,064	23,847
Interest cost on projected benefit obligation	33,411	31,394
Expected return on plan assets	(32,674)	(26,585)
Amortization of actuarial losses	5,074	11,451
Amortization of prior service cost	(236)	(236)
Net periodic pension cost	<u>27,639</u>	<u>39,871</u>
Other changes in plan assets and benefit obligations recognized in unrestricted net assets		
Net actuarial loss	129,818	(64,633)
Amortization of net actuarial losses	(5,074)	(11,451)
Amortization of prior service cost	135	134
Prior service credit	102	103
Other	—	6,174
	<u>124,981</u>	<u>(69,673)</u>
Total recognized in net periodic benefit costs and unrestricted net assets	\$ <u>152,620</u>	<u>(29,802)</u>

Weighted average assumptions used to determine net periodic pension cost for the years ended June 30, 2012 and 2011 were as follows

	<u>2012</u>	<u>2011</u>
Weighted average discount rate	5.75%	5.50%
Expected return on plan assets	8.00	8.00
Rate of compensation increase	3.50 – 4.25	4.00

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

The defined benefit pension plan asset allocation as of the measurement date (June 30, 2012 and 2011) and the target asset allocation, presented as a percentage of total plan assets, were as follows:

	<u>2012</u>	<u>2011</u>	<u>Target allocation</u>
U S Equity	17%	17%	15% – 25%
Global equity	13	13	10 – 20
Real assets	8	8	5 – 15
Fixed income and cash	33	33	10 – 25
Emerging markets	4	3	3 – 10
Alternative investments – hedge funds	21	22	15 – 35
Alternative investments – private equity funds	4	4	2 – 10

FMOLHS overall expected long-term rate of return on assets is 8.0%. The expected long-term rate of return is based on the portfolio as a whole and not on the sum of the returns on individual asset categories. The return is based on historical returns, without adjustments.

FMOLHS provides investment oversight for all of the FMOLHS Affiliates' defined benefit plans. Asset allocations and investment performance are formally reviewed quarterly by the FMOLHS Investment Committee (Investment Committee). FMOLHS utilizes an investment advisor, multiple managers for different asset classes, and a separate custodian in managing the pooled funds.

The asset allocation is designed to provide a diversified mix of asset classes, including U.S. and foreign equity securities, fixed income securities, hedge funds, real estate investment trusts, and cash. The investment goals for the pooled funds are to achieve returns in the top half of a representative universe of professionally managed funds with a percentage of equity, fixed income, and alternate investments to be indicative of the asset mix policy of the fund, to exceed the return of a balanced market index weighted to replicate the asset allocation policy of the plan, to exceed the rate of inflation as measured by the consumer price index (CPI) by at least 500 basis points on an annualized basis, to achieve a positive risk-adjusted return, and to achieve a rate of return above the current actuarial assumption. Risk management practices include various criteria for each asset class, including measurement against various benchmarks, achievement of a positive risk-adjusted return, and investment guidelines for each class of assets that enumerate types of investments allowed in each category.

The Company's retirement plan assets are reported at fair value. Level 1 assets include investments in publicly traded equity securities and mutual funds. These securities (or the underlying investments of the funds) are actively traded and valued using quoted prices for identical securities from the market exchanges. Level 2 assets consist of fixed-income securities and commingled funds that are not actively traded or whose underlying investments are valued using observable marketplace inputs. The fair value of plan assets invested in fixed-income securities is generally determined using valuation models that use observable inputs such as interest rates, bond yields, low-volume market

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

quotes and quoted prices for similar assets. Plan assets that are invested in commingled funds are valued using a unit price or net asset value (NAV) that is based on the underlying investments of the fund. Level 3 assets include investments in private equities and hedge funds valued using significant un-observable inputs.

The following is a summary of the levels within the fair value hierarchy of plan assets as of June 30, 2012 and 2011:

	June 30, 2012			
	Level 1	Level 2	Level 3	Total
Asset category				
Cash	\$ 32,597	—	—	32,597
Equity securities				
U S companies	45,831	11,668	15,758	73,257
International companies	39,480	13,078	—	52,558
Real assets	17,468	13,965	—	31,433
Fixed income securities				
U S government guaranteed	7,881	—	—	7,881
U S agency	—	11,805	—	11,805
Corporate	—	17,521	—	17,521
Municipal	—	1,252	—	1,252
Other	11,742	53,645	2,678	68,065
Emerging markets	—	7,424	8,866	16,290
Alternative asset funds				
Hedge funds	—	—	89,843	89,843
Private equity funds	—	—	17,565	17,565
Total	\$ 154,999	130,358	134,710	420,067

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

June 30, 2011				
	Level 1	Level 2	Level 3	Total
Asset category				
Cash	\$ 48,935	—	—	48,935
Equity securities				
U S companies	41,265	12,601	14,288	68,154
International companies	39,765	12,157	—	51,922
Real assets	16,798	14,684	—	31,482
Fixed income securities				
U S government guaranteed	1,511	—	—	1,511
U S agency	—	10,061	—	10,061
Corporate	—	28,396	—	28,396
Municipal	—	1,179	—	1,179
Other	11,282	41,443	1,576	54,301
Emerging markets	—	—	11,008	11,008
Alternative asset funds				
Hedge funds	—	—	90,056	90,056
Private equity funds	—	—	15,627	15,627
Total	\$ 159,556	120,521	132,555	412,632

The following tables present a roll-forward of the fair value of Level 3 (significant unobservable inputs) plan assets for the years ended June 30, 2012 and 2011

June 30, 2012						
	Hedge Fund	Private Equity	Emerging Markets	Equity	Fixed Income	Total
Beginning balance as of June 30, 2011	\$ 90,056	15,627	11,008	14,288	1,576	132,555
Transfers into Level 3	—	—	—	—	—	—
Transfers out of Level 3	—	—	—	—	—	—
Total gains or losses						
Realized and unrealized gains and losses						
Relating to assets held at end of year	(881)	1,119	(2,142)	1,470	4	(430)
Relating to assets sold during the year	222	—	—	—	—	222
Purchases, issuances, sales, and settlements						
Purchases	9,135	2,226	—	—	1,760	13,121
Sales	(8,689)	(1,407)	—	—	(662)	(10,758)
Ending balance as of June 30, 2012	\$ 89,843	17,565	8,866	15,758	2,678	134,710

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

	June 30, 2011					
	Hedge Fund	Private Equity	Emerging Markets	Equity	Fixed Income	Total
Beginning balance as of June 30, 2010	\$ 64,878	10,551	9,845	10,772	—	96,046
Transfers into Level 3	—	—	—	—	—	—
Transfers out of Level 3	—	—	—	—	—	—
Total gains or losses						
Realized and unrealized gains and losses						
Relating to assets held at year end	5,699	1,716	2,663	3,516	2	13,596
Relating to assets sold during the year	—	—	—	—	—	—
Purchases, issuances, sales, and settlements						
Purchases	25,100	3,449	—	—	1,574	30,123
Sales	(5,621)	(89)	(1,500)	—	—	(7,210)
Ending balance as of June 30, 2011	<u>\$ 90,056</u>	<u>15,627</u>	<u>11,008</u>	<u>14,288</u>	<u>1,576</u>	<u>132,555</u>

The asset allocation policy provides for a range of minimum and maximum investments in each asset class to allow flexibility in achieving expected long-term rate of return. Historical return patterns and correlations, consensus return forecast, and other relevant financial factors are analyzed to check for reasonableness and appropriateness of the asset allocation to ensure that the probability of meeting actuarial assumptions is reasonable. The Investment Committee monitors manager performance, rate of return, and risk factors on a quarterly basis and makes required adjustments to achieve expected returns.

As of June 30, 2012 and 2011, the plans had accumulated benefit obligations (ABO) of \$637,633 and \$517,259, respectively. At June 30, 2012 and 2011, the fair value of plan assets falls short of the ABO by \$217,506 and \$104,627, respectively.

The FMOLHS Affiliates expects to contribute approximately \$29,000 to the defined benefit pension plans in fiscal year 2013.

The estimated net gain (loss) and prior service cost that will be amortized from unrestricted net assets into net periodic benefit cost over the next fiscal year is \$(20,733) and \$(13,452), respectively.

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

Future benefit payments expected to be paid in each of the next five fiscal years and five years thereafter as of June 30, 2012 are as follows

Year ending June 30	
2013	\$ 17,834
2014	20,117
2015	22,727
2016	25,575
2017	28,404
2018 – 2022	187,032

(b) Defined Contribution Plans

The FMOLHS Affiliates also sponsor 403(b) and 401(k) plans. These defined contribution plans are available to substantially all employees. No contributions are made to the plans by the FMOLHS Affiliates.

The defined benefit pension plan was closed to new entrants in 2006 and a new defined contribution plan was created for those hired after June 30, 2006, the FMOL Health System Retirement Plan (FMOL Plan). Substantially all employees of the FMOLHS Affiliates meeting eligibility requirements may participate in the FMOL Plan. The FMOLHS Affiliates may annually elect to make a contribution on behalf of those participants in an amount determined by the FMOLHS Affiliates. Contribution expense of \$4,085 and \$6,013 was recorded for the years ended June 30, 2012 and 2011, respectively.

(c) Retiree Medical Plan

Lourdes offers partially subsidized healthcare benefits to employees who retired before June 30, 2006. Costs are accrued for this plan during the service lives of covered employees. Retirees contribute a portion of the self-funded cost of healthcare benefits and Lourdes contributes the remainder. The healthcare plan is funded on a pay-as-you-go basis. Lourdes retains the right to modify or terminate the benefits and/or cost sharing provisions. The accrued liability for such benefits was approximately \$819 and \$1,022 at June 30, 2012 and 2011, respectively, and is included in other long-term liabilities.

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

(16) Functional Expenses

The FMOLHS Affiliates provide healthcare and other services to residents within its service area. Expenses related to providing these services for the years ended June 30, 2012 and 2011 are as follows.

	<u>2012</u>	<u>2011</u>
Healthcare services	\$ 968,579	920,411
General and administrative	394,146	375,157
Educational services	20,350	21,639
Fund-raising	2,930	2,167
	<u>\$ 1,386,005</u>	<u>1,319,374</u>

(17) Fair Value of Financial Instruments

(a) Fair Value of Financial Instruments

The carrying amounts of all applicable asset and liability financial instruments reported in the consolidated balance sheets, except for long-term debt, approximate their estimated fair values, in all significant respects, at June 30, 2012 and 2011

FMOLHS's financial instruments for which estimated fair values differ from their carrying amounts at June 30, 2012 and 2011 are summarized as follows

	<u>2012</u>		<u>2011</u>	
	<u>Carrying amount</u>	<u>Estimated fair value</u>	<u>Carrying amount</u>	<u>Estimated fair value</u>
Liabilities – long-term debt	\$ 521,417	578,881	536,294	553,203

The fair value of long-term debt which is a Level 2 estimate is determined by discounting the future cash flows of each instrument at rates that reflect rates currently observed in publicly trade debt markets for debt of similar terms to companies with comparable credit risk

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

(b) Fair Value Hierarchy

The following table presents the placement in the fair value hierarchy of assets and liabilities that are measured at fair value on a recurring basis as of June 30, 2012 and 2011

	June 30, 2012			Total
	Level 1	Level 2	Level 3	
Assets category				
Equity securities				
U S companies	\$ 63,948	—	—	63,948
International companies	59,610	—	—	59,610
Real assets	28,977	—	—	28,977
Fixed income securities				
U S government guaranteed	3,620	—	—	3,620
U S agency	—	40,712	—	40,712
Corporate	—	34,717	—	34,717
Municipal	—	1,392	—	1,392
Other	46,894	6,503	—	53,397
Comingled funds				
Equity funds	—	—	100	100
Interest rate swaps	—	5,573	—	5,573
Total – categorized	\$ 203,049	88,897	100	292,046
Assets limited as to use and short-term investments accounted for using the equity method cash and interest accrued – uncategorized				425,080
				\$ 717,126
Liabilities				
Interest rate swaps	\$ —	25,701	—	25,701

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

June 30, 2011				
	Level 1	Level 2	Level 3	Total
Assets category				
Equity securities				
U S companies	\$ 55,062	—	—	55,062
International companies	59,365	—	—	59,365
Real assets	31,046	—	—	31,046
Fixed income securities				
U S government guaranteed	6,136	—	—	6,136
U S agency	—	22,422	—	22,422
Municipal	—	1,502	—	1,502
Other	46,052	39,248	—	85,300
Alternative asset funds				
Hedge funds	—	103	—	103
Interest rate swaps	—	8,478	—	8,478
Total – categorized	\$ 197,661	71,753	—	269,414
Assets limited as to use and short-term investments accounted for using the equity method cash and accrued interest – uncategorized				481,864
				\$ 751,278
Liabilities				
Interest rate swaps	\$ —	14,487	—	14,487

FMOLHS's accounting policy is to recognize transfers between levels of the fair value hierarchy on the date of the event or change in circumstances that caused the transfer. There were no significant transfers into or out of Level 1, Level 2, or Level 3 for the years ended June 30, 2012 or 2011.

The investments classified as Level 2 are as follows:

- Shares or units in investment funds as opposed to direct interests in the funds' underlying holdings, which may be marketable. Because the net asset value reported by each fund is used as a practical expedient to estimate the fair value of FMOLHS's interest therein, its classification in Level 2 is based on FMOLHS's ability to redeem its interest at or near the date of the consolidated balance sheets. If the interest can be redeemed in the near term, the investment is classified in Level 2. The classification of investments in the fair value hierarchy is not necessarily an indication of the risks, liquidity, or degree of difficulty in estimating the fair value of each investment's underlying assets and liabilities.

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

- Bonds whose fair values are determined by independent vendors. The vendors compile prices from various sources and may apply matrix pricing for similar bonds or loans where no price is observable in an actively traded market. If available, the vendor may also use quoted prices for recent trading activity of assets with similar characteristics to the bond being valued.

(c) Limitations

Fair value estimates are made at a specific point in time, based on relevant market information and information about the financial instruments. These estimates are subjective in nature and involve uncertainties and matters of significant judgment and, therefore, cannot be determined with precision. Changes in assumptions could significantly affect the estimates.

(18) Insurance Programs

The FMOLHS Affiliates are qualified under the State of Louisiana medical malpractice program and are self-insured for the first \$100 of professional liability per occurrence; additional coverage is provided by the Louisiana Patients' Compensation Fund for the next \$400 of professional liability up to the present statutory maximum of \$500 per claim (exclusive of additional amounts for future medical expense provided by law). FMOLHS's professional and general liability insurance program is managed through Louise, its wholly owned captive insurer. As of June 30, 2012, FMOLHS has significant excess insurance coverage in place for general and professional liability risks, with a \$2,000 layer of self-insurance retention for professional liability and \$1,000 layer of self-insurance retention for general liability, with a \$6,000 aggregate. Incurred losses identified under FMOLHS's incident reporting system and incurred but not reported losses are accrued based on estimates that incorporate FMOLHS's past experience, as well as other considerations such as the nature of each claim or incident, relevant trend factors, and advice from consulting actuaries. The reserve for estimated professional and general liability costs is approximately \$29,754 and \$27,075 as of June 30, 2012 and 2011, respectively. Claims liabilities are estimated at the present value of future claims payments using a discount rate of 3% at June 30, 2012.

FMOLHS has established a self-insurance trust fund for payment of liability claims and makes deposits to the fund in amounts determined by consulting actuaries. FMOLHS also has substantial excess liability coverage available under the provisions of certain claims-made policies, currently expiring on June 30, 2012. To the extent that any claims-made coverage is not renewed or replaced with equivalent insurance, claims based on occurrences during the term of such coverage, but reported subsequently, would be uninsured. Management believes, based on incidents identified through FMOLHS's incident reporting system, that any such claims would not have a material effect on FMOLHS's results of operations or financial position. In any event, management anticipates that the claims-made coverage currently in place will be renewed or replaced with equivalent insurance as the term of such coverage expires.

FMOLHS is also self-insured with respect to employee health coverage (up to a \$500 limit per claim) and workers' compensation (up to a limit of \$350 per individual claim). Substantial coverage with a third-party carrier is maintained for potential excess losses under the workers' compensation program. The employee health self-insured reserves are approximately \$7,428 and \$10,022 as of June 30, 2012 and 2011, respectively, and are included in other current liabilities in the consolidated balance sheets. The workers'

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

compensation reserves are approximately \$10,908 and \$11,438 as of June 30, 2012 and 2011, respectively, and are included in other current liabilities in the consolidated balance sheets

(19) Leases – Lessor

FMOLHS Affiliates lease office space and clinical facilities, generally to medical staff members, under operating leases. The terms of these leases range from month-to-month to 10 years. Assets held for lease at June 30, 2012 and 2011 consist of buildings and improvements with an original cost of \$181,641 and \$166,186, respectively, and fixed equipment with an original cost of \$11,813 and \$11,758, respectively. Total accumulated depreciation is \$68,048 and \$61,273 at June 30, 2012 and 2011, respectively. Future minimum lease payments to be received at June 30, 2012 are as follows:

Year ending June 30	
2013	\$ 8,837
2014	8,257
2015	7,839
2016	6,112
2017	5,197
Thereafter	29,141
	<u>\$ 65,383</u>

(20) Commitments and Contingencies

(a) Investments

As it relates to alternative assets, FMOLHS is obligated under certain limited partnership agreements to provide advance funding up to specific levels upon the request of the general partner. See note 2(b).

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

(b) Capital leases

As of June 30, 2012, the Lake, St Francis, Lourdes, and St Elizabeth were obligated under various capital leases, each with noncancelable terms in excess of one year. Future minimum lease payments as of June 30, 2012 are as follows:

Year ending June 30	
2013	\$ 5,768
2014	4,919
2015	4,061
2016	3,765
2017	88
	<hr/>
Total minimum lease payments	18,601
Less amounts representing interest (rates ranging from 6.0% to 14.5%)	<hr/> 1,324
Present value of future minimum lease payments	17,277
Less current portion of capital lease obligations	<hr/> 5,103
Capital lease obligations excluding current portion	<hr/> <u>\$ 12,174</u>

The net book value of assets under capital lease as of June 30, 2012 and 2011 was \$22,630 and \$25,169, respectively.

For the years ended June 30, 2012 and 2011, FMOLHS entered into new capital leases for equipment in the amount of \$7,693 and \$14,817, respectively.

In late 2010, the FASB issued for comment *Proposed Accounting Standards Update-Leases (Topic 840)*. After receiving and considering significant feedback, the FASB intends to issue a related final ASU in calendar year 2013. This new guidance is expected to require FMOLHS to recognize virtually all of its leases in the consolidated balance sheet. Assuming the ASU is in fact issued, adoption will cause considerable changes in the presentation of FMOLHS's debt and interest expense in its consolidated financial statements (among other things). Management is reviewing the implications of the proposed ASU for FMOLHS, including potential implications for many complex agreements and arrangements which might be impacted by this potential major accounting change. While that work is ongoing, management is optimistic that there will not be material issues associated with important related matters, such as overall FMOLHS credit ratings or future debt covenant compliance.

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

(c) Operating Leases – Lessor

Rental expense for all operating leases totaled \$11,376 and \$8,210 for the years ended June 30, 2012 and 2011, respectively. Future minimum rental payments under operating leases that have initial or remaining noncancelable terms in excess of one year as of June 30, 2012 follow

Year ending June 30.	
2013	\$ 4,695
2014	3,166
2015	2,808
2016	1,994
2017	1,675
Thereafter	9,165
	<hr/>
	\$ 23,503
	<hr/>

(d) St. Francis Specialty Hospital

During the years ended June 30, 2012 and 2011, St Francis had a leasing arrangement with St Specialty Extended Care Hospital of Monroe, LLC (Extended Care), a distinct and separate long-term care hospital, with rates based on square footage. In addition to the lease arrangement, a separate services agreement existed for the provision of ancillary, clinical and support services, based on fair market value rates. This lease and services agreement was effective November 1, 2009 between St Francis and St Francis Specialty Hospital (Specialty), and was subsequently assigned to Extended Care as a result of an asset purchase agreement between Specialty and Extended Care. The initial term was for five years, with automatic renewal of the lease for subsequent one-year terms unless written notice is given. Rental income and income related to the services agreement with Extended Care totaled \$2,594 and \$2,905 for the years ended June 30, 2012 and 2011, respectively. Amounts due from Extended Care at June 30, 2012 and 2011 were \$506 and \$585, respectively.

(e) Community Health Center Lease

An amended lease was executed by St Francis for the Community Health Center (CHC) space during the year ended June 30, 1998. The amended lease provided for an expansion of the leased premises through construction of an addition to the CHC building by St Francis Ambulatory Services, Inc (SFASI) at the leased site. The building was completed during the year ended June 30, 1999, and SFASI took occupancy of the building. Concurrently, the lease term was extended through August 31, 2014, and annual rentals increased to \$449 through September 2008 and the greater of \$601 annually, or an increase based upon the CPI through termination of the lease.

(f) Perkins Plaza ASC

The Lake's subsidiary, Perkins Plaza Medical Arts Development (PPMAD), has a lease with Perkins Plaza ASC, an equity investment, whereby PPMAD receives minimum rent of \$815 per year subject

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

to annual adjustments. Monthly rental installments were \$67 from January 2010 through December 2010 and \$68 beginning in January 2011. The lease expires in January 2015.

(g) *Asset Retirement Obligations*

FMOLHS recognizes obligations associated with the future retirement of long-lived assets. Estimated asset retirement obligations of \$3,462 and \$3,386 for the years ended June 30, 2012 and 2011, respectively, are classified as a long-term liability.

(h) *Contingent Liabilities*

FMOLHS and the FMOLHS Affiliates have certain pending and threatened litigation and claims incurred in the ordinary course of business; however, management believes that the probable resolution of such contingencies will not exceed the self-insurance reserves or insurance coverage, and will not materially affect the financial position or the results of operations.

FMOLHS Affiliates, like other hospitals throughout Louisiana, is a defendant in cases where the plaintiff has developed Hepatitis C allegedly through blood transfusions administered at the hospital prior to the 1976 Medical Malpractice Act. Thus, no \$500 statutory cap exists relating to these claims, and damages could be significant. Lourdes and the insurer that were in place during the period the transfusions occurred continue to closely monitor the progress of these cases. Management has assessed the risk associated with these cases and believes that the probable resolution of this contingency will not exceed the hospital's self-insurance reserves or insurance coverage and will not materially affect the financial position or results of operations of the hospital.

During the fall of 2003, the Chief Executive Officer of Lourdes was advised by a physician with privileges at Lourdes that another physician with privileges at Lourdes, as well as other area hospitals, may have performed medically unnecessary procedures at Lourdes. Based on its internal investigation, management at Lourdes concluded that the allegations were credible and on November 11, 2003 (the Self-Reporting Date), reported the matter to the Office of the Inspector General (OIG) and the United States Attorney's Office in Lafayette, Louisiana (the Justice Department).

On August 16, 2006, Lourdes, without admitting or denying fault, agreed to pay \$3,800 in full settlement of all claims by the federal and state governments relating to alleged violations of the False Claims Act. As a component of this settlement, Lourdes also entered into a Corporate Integrity Agreement (CIA) with the OIG to promote compliance with statutes, regulations, and written directives for Federal Health Care Programs. The Corporate Integrity Agreement (CIA) covered a period of five years and expired during 2011.

While the settlement agreement and CIA resolved this matter with respect to government regulatory authorities, it did not conclude the matter with respect to individual claimants. Lourdes agreed to pay a total of \$7,400 as part of a global settlement agreement with all current and future individual claimants. On May 11, 2007, Lourdes settled with all but three of the individual claimants, who opted out of the global settlement agreement. The cost of the global settlement was paid by Louise.

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

As of June 30, 2012, the three remaining claimants are awaiting evaluation by a Medical Review Panel

Under the laws of the State of Louisiana, any claim for damages resulting from medical malpractice must be reviewed by a Medical Review Panel unless waived by all parties. A Medical Review Panel is charged with determining whether there has been a breach of the standard of care by a healthcare provider, as well as determining whether such breach caused damage to a claimant. A Medical Review Panel does not establish the Level of damages and is not the tier of fact. All determinations made by the Medical Review Panel may be used in related lawsuits for evidentiary purposes only.

Under the laws of the State of Louisiana, damages for negligence by qualified healthcare providers, such as Lourdes, relating to claims for medical malpractice are limited to \$100; punitive damages are not recoverable in the State of Louisiana. Any damages in excess of \$100 for medical malpractice claims are payable from the Patients Compensation Fund created and established pursuant to the laws of the State of Louisiana, but in no event shall the amounts paid therefrom exceed \$400 per claim.

Damages for claims for intentional acts by qualified healthcare providers relating to medical malpractice have no limitation. In addition, damages for claims for negligent credentialing of a physician by a qualified healthcare provider have no limitation.

Management at Lourdes has denied that its actions or failure to act in connection with these matters were negligent or intentional, or that the credentialing of the physician was negligent. Management at Lourdes has been advised by legal counsel that at this stage of litigation, it is not possible to estimate the extent of potential liability with respect to the remaining individual claimants.

(i) Regulatory Compliance

The U.S. Department of Justice and other federal agencies are increasing resources dedicated to regulatory investigations and compliance audits of healthcare providers. The FMOLHS Affiliates are subject to these regulatory efforts and have corporate compliance committees that monitor and respond to regulatory changes and any issues that may arise.

In consultation with legal counsel, management is not aware of any issues that could have a material adverse effect on the FMOLHS Affiliates' financial position or results of operations.

(j) Information Technology Contract

During fiscal year 2009, FMOLHS entered into a variety of contracts with a major information technology vendor. The agreements are generally for terms of seven years. The contracts generally commit FMOLHS to the purchase of a variety of information technology products and services from this vendor for defined payment streams over the terms of the contracts. Certain software license and related implicit maintenance costs were capitalized at the inception of the agreements in the amount of \$17,621, with recognition of an associated liability related to FMOLHS's acquisition of these intangible assets. Capitalized software and implied maintenance costs are being amortized over the

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

estimated useful life of the software licenses (generally seven years) and the implicit maintenance period (which varies depending on first date of productive use), respectively. Other contract costs are evaluated for capitalization or expense recognition under relevant accounting literature as associated products and/or services are provided.

The following table summarizes FMOLHS's future payment commitments under the contract as of June 30, 2012:

	Capitalized software obligation	Other
2013	\$ 3,137	7,245
2014	3,137	7,245
2015	3,137	7,245
2016	1,047	7,245
Total	10,458	\$ 28,980
Less amounts representing interest at 6.74%	1,163	
Long-term obligation (included in other long-term liabilities)	\$ 9,295	

(21) Cooperative Endeavor Agreement

As part of its mission to ensure an appropriate supply of medical professionals in its service area and improve graduate medical education in the region, the Lake entered into an agreement with the State of Louisiana Department of Health and Hospitals (DHH) and Louisiana State University Health Sciences (LSU) in February 2010. The parties received associated governmental approval of the agreement from the Center for Medicare and Medicaid Services (CMS) on July 13, 2010. Major components of the agreement follow:

- The Lake will construct a medical education building (MEB) to house LSU training programs (to be donated by the Lake to LSU at completion of construction), expand its clinical capacity by 60 licensed beds, and implement a Trauma Center. The Lake has recorded \$19,000 in other long-term liabilities in the consolidated balance sheets as of June 30, 2012 and 2011 and an associated other expense was recorded in the consolidated statement of operations for the year ended June 30, 2011 to reflect its promise to give in accordance with relevant accounting literature, related to the MEB.
- DHH will provide payments under a new reimbursement structure to the Lake, which are intended to compensate the Lake for incremental costs associated with higher Medicaid and uninsured patient volumes that are generally expected to accompany the Lake's increased role in LSU's graduate medical education program.

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Notes to Consolidated Financial Statements

June 30, 2012 and 2011

(in thousands)

- During the year ended June 30, 2011, DHH submitted a State Plan Amendment that obligated itself to make supplemental Medicaid payments to the Lake equal to a total of \$129,000 for the period October 1, 2009 through June 30, 2011. These amounts were received by the Lake during its fiscal year 2011 and were included in net patient services revenue for the year ended June 30, 2011 as a reduction in related contractual and other adjustments.

(22) Subsequent Events

FMOLHS has evaluated subsequent events from the consolidated balance sheet date through October 9, 2012, the date the consolidated financial statements were issued.

On October 3, 2012, the Authority issued its Hospital Revenue Refunding Bonds (Franciscan Missionaries of Our Lady Health System Project) Series 2012A in the original principal amount of \$56,530 (the "Series 2012A Bonds") for the purpose of advance refunding its Hospital Revenue Bonds (Franciscan Missionaries of Our Lady Health System Project) Series 2005C (the "Series 2005C bonds") and paying the costs of issuance of the Series 2012A Bonds. A portion of the proceeds of the Series 2012A Bonds and other monies available to the FMOLHS were deposited in an Escrow Fund created pursuant to an Escrow Deposit Agreement dated the date of delivery of the Series 2012A Bonds for the purpose of defeasing and advance refunding the Series 2005C Bonds.

SUPPLEMENTAL SCHEDULES

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Consolidating Schedule – Balance Sheet Information

June 30, 2012
(with comparative totals as of June 30, 2011)
(In thousands)

	Franciscan Missionaries of Our Lady Health System, Inc.	Our Lady of the Lake Regional Medical Center, Inc. and affiliated organizations	St. Elizabeth Hospital	St. Francis Medical Center, Inc. and subsidiaries	Our Lady of Lourdes Regional Medical Center, Inc. and subsidiaries	Others	Eliminations	2012	2011
Assets									
Current assets									
Cash and cash equivalents	\$ 11,016	122,126	15,696	13,321	9,425	18,422	—	190,006	218,195
Short-term investments	2,150	15,043	—	1	—	344	—	17,538	21,254
Receivables	—	145,244	19,662	46,234	52,741	1,015	—	264,896	240,225
Patients	—	(39,795)	(8,358)	(11,853)	(13,138)	—	—	(73,144)	(64,441)
Less allowance for uncollectible accounts	—	105,449	11,304	34,381	39,603	1,015	—	191,752	175,784
Net patient receivables	—	—	—	—	—	—	—	—	—
Other current assets	7,303	44,061	2,590	19,239	14,768	1,411	(7,648)	81,714	88,980
Total current assets	20,469	286,679	29,590	66,932	63,796	21,192	(7,648)	481,010	504,213
Noncurrent assets limited as to use	—	465,975	4,875	154,069	20,272	23,321	—	668,512	690,785
Property and equipment net	46,891	508,172	54,585	109,358	279,884	372	—	999,262	944,292
Property and equipment held for sale	—	—	—	—	—	—	—	—	15,055
Other assets	9,184	53,363	7,122	29,319	34,239	4,817	(25,283)	112,761	106,063
Total assets	\$ 76,544	1,314,189	96,172	359,678	398,191	49,702	(32,931)	2,261,545	2,260,408
Liabilities and Net Assets									
Current liabilities									
Lines of credit	—	—	805	—	5,191	—	—	5,996	4,650
Current installments of long-term debt	—	9,627	407	4,567	4,426	—	—	19,027	17,585
Current portion of capital lease obligations	—	1,144	390	465	3,104	—	—	5,103	4,649
Accounts payable	4,925	27,233	2,413	8,521	9,736	698	(91)	53,435	75,487
Other current liabilities	15,178	95,048	11,049	21,009	14,227	20,246	(7,557)	169,200	153,491
Total current liabilities	20,103	133,052	15,064	34,562	36,684	20,944	(7,648)	252,761	255,862
Professional and general liabilities excluding current portion	—	15,614	2,226	5,436	3,466	24,065	(23,510)	28,472	25,587
Long-term debt excluding current installments	1,175	201,586	15,360	135,665	149,779	—	—	502,390	518,709
Capital lease obligations excluding current portion	—	959	565	684	9,966	—	—	12,174	16,843
Accrued pension cost	—	188,003	—	49,764	66,824	—	—	304,591	176,003
Other long-term liabilities	34,995	19,597	—	2,447	3,134	2,027	—	62,200	52,782
Total liabilities	56,273	558,811	33,215	228,558	269,853	47,036	(31,158)	1,162,588	1,045,786
Net assets									
Unrestricted	20,271	728,251	62,668	130,006	123,460	2,597	(1,773)	1,065,480	1,180,209
Temporarily restricted	—	19,253	366	1,114	—	69	—	20,802	18,609
Permanently restricted	—	5,300	—	—	210	—	—	5,510	5,516
Total net assets attributable to Franciscan	20,271	752,804	63,034	131,120	123,670	2,666	(1,773)	1,091,792	1,204,334
Missionaries of Our Lady Health System, Inc	—	—	(77)	—	4,668	—	—	7,165	10,288
Noncontrolling interests	—	2,574	—	—	—	—	—	—	—
Total net assets	20,271	755,378	62,957	131,120	128,338	2,666	(1,773)	1,098,957	1,214,622
Total liabilities and net assets	\$ 76,544	1,314,189	96,172	359,678	398,191	49,702	(32,931)	2,261,545	2,260,408

See accompanying independent auditors' report

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Consolidating Schedule – Statement of Operations Information

Year ended June 30 2012

(with comparative totals for the year ended June 30 2011)

(In thousands)

	Our Lady of the Lake Regional Medical Center, Inc. and affiliated organizations	St. Elizabeth Hospital	St. Francis Medical Center Inc and subsidiaries	Our Lady of Lourdes Regional Medical Center, Inc. and subsidiaries	Others	Eliminations	Total
							2012
							2011
Changes in unrestricted net assets							
Unrestricted revenues							
Net patient service revenue	\$ —	105,066	247,055	240,652	—	—	1,319,535
Other revenue	86,189	1,334	10,939	9,025	15,027	(99,778)	89,943
Equity in income from equity investees, net	—	(87)	2,775	4,162	—	—	12,033
Total unrestricted revenues	86,189	106,313	260,769	253,839	15,027	(99,778)	1,421,511
Net assets released from restrictions used for operations	—	2,448	—	—	48	—	2,780
Satisfaction of program restrictions	—	133	—	—	—	—	133
Expiration of time restrictions	—	2,581	—	—	48	—	2,913
Total net assets released from restrictions	86,189	106,597	260,769	253,839	15,075	(99,778)	1,424,424
Total unrestricted revenues and other support							
Operating expenses							
Salaries and wages	36,586	40,468	98,016	71,433	2,807	—	519,767
Employee benefits	8,368	8,277	22,624	15,246	308	—	111,761
Total salaries, wages, and benefits	44,954	48,745	120,640	86,679	3,115	—	631,528
Provision for uncollectible accounts	—	15,381	8,937	21,840	—	—	123,500
Physician fees	—	126	4,222	11,515	—	—	30,570
Professional services	430	448	3,819	1,732	295	—	15,973
Other services	37,871	15,349	43,801	36,818	4,671	(92,501)	171,469
Leases, insurance and utilities	3,150	3,225	9,564	10,289	6,481	(7,277)	46,384
Supplies and other	931	10,922	44,930	51,976	298	—	257,758
Depreciation and amortization	14,810	4,801	13,324	16,827	84	—	79,153
Interest	729	721	6,615	8,179	—	—	26,537
Other	89	—	434	1,024	6	—	3,133
Total operating expenses	102,964	99,718	256,286	246,879	14,950	(99,778)	1,386,005
Operating income (loss)	(16,775)	6,879	4,483	6,960	125	—	38,419

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Consolidating Schedule – Statement of Operations Information

Year ended June 30, 2012

(with comparative totals for the year ended June 30, 2011)

(In thousands)

	Franciscan Missionaries of Our Lady Health System, Inc.	Our Lady of the Lake Regional Medical Center, Inc. and affiliated organizations	St. Elizabeth Hospital	St. Francis Medical Center, Inc. and subsidiaries	Our Lady of Regional Medical Center, Inc. and subsidiaries	Others	Eliminations	2012	2011
Nonoperating gains (losses)									
Investment return	\$ 95	(4,312)	15	(1,706)	103	473	—	(5,332)	119,270
Other	—	(3,150)	—	—	(492)	(59)	(42)	(3,743)	(4,695)
Change in fair value of interest rate swap agreement	(14,118)	—	—	—	—	—	—	(14,118)	4,676
Total nonoperating gains (losses) net	(14,023)	(7,462)	15	(1,706)	(389)	414	(42)	(23,193)	119,251
Unrestricted revenues, gains, and other support in excess (less than) expenses and losses	(30,798)	29,285	6,894	2,777	6,571	539	(42)	15,226	265,556
Noncontrolling interests	—	(832)	77	—	(2,371)	—	—	(3,126)	(3,145)
Unrestricted revenues, gains, and other support in excess of (less than) expenses and losses attributable to FMOLHS	(30,798)	28,453	6,971	2,777	4,200	539	(42)	12,100	262,411
Capital transfers (to) from FMOLHS	26,338	(11,148)	(3,602)	(5,845)	(5,785)	—	42	—	—
Other	—	(1,848)	—	—	—	—	—	(1,848)	—
Pension-related changes other than net periodic pension cost	—	(78,825)	—	(18,251)	(27,905)	—	—	(124,981)	69,673
Increase (decrease) in unrestricted net assets	\$ (4,460)	(63,368)	3,369	(21,319)	(29,490)	539	—	(114,729)	332,084

See accompanying independent auditors' report

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Consolidating Schedule – Statement of Changes in Net Assets Information
Year ended June 30, 2012
(with comparative totals for the year ended June 30, 2011)
(In thousands)

	Franciscan Missionaries of Our Lady Health System, Inc.	Our Lady of the Lake Hospital, Inc. and Affiliated Organizations	St Elizabeth Hospital	St. Francis Medical Center Inc. and subsidiaries	Our Lady of Lourdes Regional Medical Center, Inc. and subsidiaries	Others	Eliminations	2012	2011
Unrestricted revenues, gains and other support in excess of (less than) expenses and losses attributable to FMOLHS	\$ (30,798)	28,453	6,971	2,777	4,200	539	(42)	12,100	262,411
Capital transfers (to) from FMOLHS	26,338	(11,148)	(3,602)	(5,845)	(5,785)	—	42	—	—
Other	—	(1,848)	—	—	—	—	—	(1,848)	—
Pension-related changes other than net periodic pension cost	—	(78,825)	—	(18,251)	(27,905)	—	—	(124,981)	69,673
Increase (decrease) in unrestricted net assets	(4,460)	(63,368)	3,369	(21,319)	(29,490)	539	—	(114,729)	332,084
Changes in temporarily restricted net assets									
Contributions	—	4,662	401	—	—	(1)	—	5,062	5,185
Income from long-term investments, net	—	—	—	1	—	—	—	1	1
Net unrealized and realized loss on investments, net	—	(2,581)	(285)	15	—	—	—	15	35
Net assets released from restrictions	—	28	—	—	—	(47)	—	(2,913)	(5,489)
Acquired net assets	—	—	—	—	—	—	—	28	—
Increase (decrease) in temporarily restricted net assets	—	2,109	116	16	—	(48)	—	2,193	(268)
Changes in permanently restricted net assets	—	—	—	—	(6)	—	—	(6)	11
Changes in noncontrolling interest									
Unrestricted revenues, gains and other support in excess of expenses and losses attributable to FMOLHS	—	832	(77)	—	2,371	—	—	3,126	3,145
Distributions	—	(1,708)	—	—	(3,475)	—	—	(5,183)	(3,207)
Sale of noncontrolling interests	—	—	—	—	—	—	—	—	1,207
Acquired non-controlling interest	—	—	—	—	(1,066)	—	—	(1,066)	—
Changes in noncontrolling interest	—	(876)	(77)	—	(2,170)	—	—	(3,123)	1,145
Increase (decrease) in net assets	(4,460)	(62,135)	3,408	(21,303)	(31,666)	491	—	(115,665)	332,972
Net assets, beginning of year (as adjusted)	24,731	817,513	59,549	152,423	160,004	2,175	(1,773)	1,214,622	881,650
Net assets, end of year	\$ 20,271	\$ 755,378	\$ 62,957	\$ 131,120	\$ 128,338	\$ 2,666	\$ (1,773)	\$ 1,098,957	\$ 1,214,622

See accompanying independent auditors' report

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Service to the Community (Unaudited)

June 30, 2012 and 2011

FMOLHS and the FMOLHS Affiliates are active, caring members of the communities they serve. In carrying out its mission of meeting the health needs of the people of God, the Board of Directors has established a policy under which FMOLHS Affiliates provide care to needy members of their communities. Following that policy, healthcare services costing \$11,216 and \$12,140 were provided without charge during the years ended June 30, 2012 and 2011, respectively. Charges foregone, based on established rates, totaled \$30,305 and \$32,084 for the years ended June 30, 2012 and 2011, respectively.

The FMOLHS Affiliates also participate in government programs including Medicare, Medicaid, and the TriCare program. Under these programs, the FMOLHS Affiliates provide care to patients at payment rates that are determined by the federal and state governments, regardless of actual cost. In some cases, these programs pay the FMOLHS Affiliates at amounts, which are less than their cost of providing services. The following table summarizes the amount of charges foregone (i.e., contractual adjustments) and the estimated losses incurred by the FMOLHS Affiliates due to inadequate payments by these programs and for charity for the years ended June 30, 2012 and 2011.

	2012		2011	
	Charges foregone	Estimated unreimbursed costs	Charges foregone	Estimated unreimbursed costs
Medicare	\$ 804,845	82,204	716,773	62,772
Medicaid	316,398	59,084	285,971	54,813
Other	6,713	1,544	5,629	1,216
Charity	30,305	11,216	32,084	12,140
	<u>\$ 1,158,261</u>	<u>154,048</u>	<u>1,040,457</u>	<u>130,941</u>

In addition to community services directly associated with providing hospital-based care, FMOLHS Affiliates serve their communities in numerous other ways. Although the FMOLHS Affiliates have estimated the cost of each of these efforts to serve their communities, management and the Boards of Directors believe that such costs represent only some of the many ways FMOLHS Affiliates serve their communities. The estimated costs for the years ended June 30, 2012 and 2011 are as follows:

	Net community benefit expense	
	2012	2011
Subsidized health services	\$ 27,985	17,709
Community health improvement services	3,504	3,669
Health professions education	7,474	11,827
Community building activities	1,212	20,517
Donations or in-kind contributions	1,419	1,221
Total	<u>\$ 41,594</u>	<u>54,943</u>

**FRANCISCAN MISSIONARIES OF OUR LADY HEALTH
SYSTEM, INC. AND AFFILIATED ORGANIZATIONS**

Service to the Community (Unaudited)

June 30, 2012 and 2011

Subsidized health services – Includes the discount provided, at cost, to all patients that have no form of insurance coverage. Programs such as St Elizabeth Community Clinic, Scott Family Clinic, St Bernadette's Clinic, Scotlandville Clinic, Kid-Med Clinic which serves the underinsured or uninsured. Mental health services and palliative care are also provided to the community,

Community health improvement services – Includes activities carried out to improve community health and costs, which are underwritten by FMOLHS Affiliates. These services include Camp Bluebird, Lafayette Community Healthcare Clinic, a medication program, Congregational Health Services, Northside High School Health Center, community seminars, immunological support, parish nurse program, LakeLine Direct, St Martha Activity Center, elderly services, and elderly housing.

Health professions education – Includes assistance to future healthcare professionals, nursing students and pharmacy students. Clinical setting for undergraduate, vocational training, internships, clerkships, and residencies. Collaboration with local colleges for supervision and clinical training in pharmacy, respiratory therapy, health information management, and medical technology. Registered nurse recruitment activities, OLOL College, and participation in Medicare's Graduate Medical Education through affiliation with Louisiana Medical School and Medical Center of Louisiana at New Orleans, will continue to support availability of future healthcare professionals.

Community building activities – Includes leadership development and training for community members such as emergency preparedness programs, community health education such as classes on breast feeding, childbirth basics, sibling class, and ABC's of childcare, community support with Meals on Wheels, community-based clinical services, including health screenings, discounted services provided to Louisiana Baptist Children's Home, Veteran's Administration, Rural Hospitals, ULM Athletic Department, MDA, Wellspring, and Handicap Children, workforce development, and provides community clinics, St Vincent DePaul Charitable Pharmacy and Mary Bird Perkins use of land and buildings.

Donations and in kind contributions – Includes donations to various area community organizations such as United Way, Families Helping Families, Children's Coalition, Wellspring, YMCA, Haiti Project, Prevent Child Abuse, Komen Foundation, Alzheimer's Foundation, March of Dimes, Junior Achievement, Cystic Fibrosis, Community Fund for the Arts and American Heart Association. Provides office space for The Family Tree Parenting Center, as well as employee costs associated with board and community involvement in various community organizations.



KPMG LLP
Suite 1700
450 Laurel Street, Suite 1700
Baton Rouge, LA 70801

**Independent Auditors' Report on Internal Control over
Financial Reporting and on Compliance and
Other Matters Based on an Audit of Financial Statements Performed
in Accordance with *Government Auditing Standards***

The Board of Trustees
Franciscan Missionaries of
Our Lady Health System, Inc.

We have audited the consolidated financial statements of Franciscan Missionaries of Our Lady Health System, Inc. and affiliated organizations (FMOLHS) as of and for the year ended June 30, 2012, and have issued our report thereon dated October 9, 2012. Our report.

- states that the supplementary information included in schedules 1 through 3 is presented for purposes of additional analysis and is not a required part of the consolidated financial statements and has been subjected to auditing procedures applied in the audit of the consolidated financial statements,
- states that the supplementary information included in schedule 4 is presented for purposes of additional analysis and is not a required part of the consolidated financial statements and has not been subjected to auditing procedures applied in the audit of the consolidated financial statements

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States

Internal Control over Financial Reporting

Management of FMOLHS is responsible for establishing and maintaining effective control over financial reporting. In planning and performing our audit, we considered FMOLHS's internal control over financial reporting as a basis for designing our auditing procedures for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of FMOLHS's internal control over financial reporting. Accordingly, we do not express an opinion on the effectiveness of FMOLHS's internal control over financial reporting.

A deficiency in internal control over financial reporting exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

Our consideration of internal control over financial reporting was for the limited purpose described in the first paragraph of this section and was not designed to identify all deficiencies in internal control over financial reporting that might be deficiencies, significant deficiencies, or material weaknesses. We did not identify any deficiencies in internal control over financial reporting that we consider to be material.



weaknesses, as defined above. However, we identified certain deficiencies in internal control over financial reporting that we consider to be significant deficiencies and that are described below. A significant deficiency is a deficiency, or combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

Accounting for Property and Equipment

Our Lady of Lourdes Regional Medical Center, Inc. does not have financial reporting policies in place to consider the classification of property and equipment on the consolidated balance sheet and the related impact to depreciation expense.

Our Lady of Lourdes Regional Medical Center, Inc. is not properly accounting for and appropriately depreciating property and equipment. In certain instances, depreciation of assets was not accurately calculated to result in fully depreciated assets. A policy should be implemented to review assets that are placed into service to ensure the depreciation calculation performed by the fixed asset system is configured to fully depreciate the asset. Our Lady of Lourdes Regional Medical Center, Inc. should also monitor assets that are retired to ensure depreciation accurately terminates at the time of retirement.

Invoices are not properly matched to purchase orders to ensure duplicate payment does not occur causing improper capitalization of invoices. Upon receipt of the ordered items or at completion of services, information should be compared to the purchase order and authorization should be reviewed to ensure proper authorization has been provided.

Management's Response

We concur with the finding. The current fixed asset policy will be revised to specify the treatment of all assets and the related depreciation, to include the matching of purchase orders with invoices prior to adding the assets in the fixed asset system, proper asset life classification and the methodology to depreciate the assets.

Accounting for Pensions

FMOLHS does not have a written policy for establishing its discount rate assumption utilized in the estimate of its pension liability and expense. The selection of the discount rate should be set in accordance with a stated policy and should result in a rate that reflects the general change in interest rates since the prior measurement date. The policy should be applied consistently from period to period. To support the discount rate selected, FMOLHS should ensure that the actuarial report and/or other documentation includes the following information:

- The specific source data used to support the discount rate
- If the discount rate is based upon a projected benefit cash flow model with either a matched bond portfolio or a yield-curve analysis, the actual bond model or yield-curve analysis should be included along with a full description of the process used to select the bonds.

Management's response

Management will establish a written policy which will be applied at each measurement date.

Materials Management Purchasing Process

Management has identified the following deficiencies in the material management process:

- Ineffective oversight of the nonsupply-related purchasing process,



- Incomplete documentation of operating procedures, scripts, and guidelines for processing nonsupply purchases,
- Lack of a purchase requisition, authorized at the entity level, to generate required purchase orders,
- Potential for nonsupply-related invoices to be paid without the appropriate entity approval as the result of an automatic match between purchase order and invoice (two-way match),
- Lack of specific authorization levels for Purchasing and AP Customer Service staff to seek approvals for material discrepancies,
- Lack of coordinated effort between the Accounts Payable and affiliate accounting departments regarding cash requirement reporting and verification that material checks have been reviewed prior to printing

Management's Response

The following corrective actions were taken

- The purchasing function supporting nonsupply-related purchases now report to the Director of Purchasing, where the appropriate work processes, controls, and systems are currently being managed for all supply purchases
- Operating procedures, system scripts, and guidelines in place for processing supply purchases will be utilized for all purchases,
- A new Mode of Purchase – Fees & Services policy will be developed and forwarded to the CFOs for review and approval,
- The AP Advisory Team will establish guidelines and controls for the use of recurring payments. All other nonsupply-related payments will require a three-way match, where the third match requires signature of the authorized entity leader,
- The supply and services purchase procedures will incorporate authorization levels for discrepancy resolution,
- The AP Advisory Team will address the coordination and verification of the cash requirements and check register reconciliation

Compliance and Other Matters

As part of obtaining reasonable assurance about whether FMOLHS's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

We noted certain matters that we reported to management of FMOLHS in a separate letter dated October 9, 2012.

FMOLHS's responses to the findings identified in our audit are described above, and in the separate letter dated October 9, 2012. We did not audit FMOLHS's responses, and accordingly, we express no opinion on them.



This report is intended solely for the information and use of management, the Board of Trustees, and others within the entity, and is not intended to be and should not be used by anyone other than these specified parties

KPMG LLP

October 9, 2012



KPMG LLP
Suite 1700
450 Laurel Street, Suite 1700
Baton Rouge, LA 70801

October 9, 2012

The Audit Leadership and Finance Committees
Franciscan Missionaries of Our Lady Health System, Inc
Baton Rouge, Louisiana

Ladies and Gentlemen

In planning and performing our audit of the consolidated financial statements of Franciscan Missionaries of Our Lady Health System, Inc (FMOLHS) as of and for the year ended June 30, 2012, in accordance with auditing standards generally accepted in the United States of America, we considered FMOLHS's internal control over financial reporting (internal control) as a basis for designing our auditing procedures for the purpose of expressing our opinion on the consolidated financial statements, but not for the purpose of expressing an opinion on the effectiveness of FMOLHS's internal control. Accordingly, we do not express an opinion on the effectiveness of FMOLHS's internal control.

Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be significant deficiencies or material weaknesses, and therefore, there can be no assurance that all deficiencies, significant deficiencies, or material weaknesses have been identified. However, as discussed below, we identified certain deficiencies in internal control that we consider to be significant deficiencies.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented. None of the significant deficiencies described below is believed to be a material weakness.

A significant deficiency is a deficiency, or combination of control deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We consider the following deficiencies in the FMOLHS's internal control to be significant deficiencies:

Accounting for Property and Equipment

Our Lady of Lourdes Regional Medical Center, Inc. does not have financial reporting policies in place to consider the classification of property and equipment on the consolidated balance sheet and the related impact to depreciation expense.



The Audit Leadership and Finance Committees
Franciscan Missionaries of Our Lady Health System, Inc
October 9, 2012
Page 2 of 7

Our Lady of Lourdes Regional Medical Center, Inc is not properly accounting for and appropriately depreciating property and equipment. In certain instances, depreciation of assets was not accurately calculated to result in fully depreciated assets. A policy should be implemented to review assets that are placed into service to ensure the depreciation calculation performed by the system is configured to fully depreciate the asset. Our Lady of Lourdes Regional Medical Center, Inc should also monitor assets that are retired to ensure depreciation accurately terminates at the time of retirement.

Invoices are not properly matched to purchase orders to ensure duplicate payment does not occur causing improper capitalization of invoices. Upon receipt of the ordered items or at completion of services, information should be compared to the purchase order and authorization should be reviewed to ensure proper authorization has been provided.

Management's Response

We concur with the finding. The current fixed asset policy will be revised to specify the treatment of all assets and the related depreciation, to include the matching of purchase orders and invoices prior to adding the assets in the fixed asset system, proper asset life classification, and the methodology to depreciate the assets.

Accounting for Pensions

FMOLHS does not have a written policy for establishing its discount rate assumption utilized in the estimate of its pension liability and expense. The selection of the discount rate should be set in accordance with a stated policy and should result in a rate that reflects the general change in interest rates since the prior measurement date. The policy should be applied consistently from period to period. To support the discount rate selected, FMOLHS should ensure that the actuarial report and/or other documentation includes the following information:

- The specific source data used to support the discount rate
- If the discount rate is based upon a projected benefit cash flow model with either a matched bond portfolio or a yield-curve analysis, the actual bond model or yield-curve analysis should be included along with a full description of the process used to select the bonds.

Management's Response

Management will establish a written policy, which will be applied at each measurement date.

Materials Management Purchasing Process

Management has identified the following deficiencies in the material management process:

- Ineffective oversight of the nonsupply related purchasing process,



The Audit Leadership and Finance Committees
Franciscan Missionaries of Our Lady Health System, Inc
October 9, 2012
Page 3 of 7

- Incomplete documentation of operating procedures, scripts, and guidelines for processing nonsupply purchases,
- Lack of a purchase requisition, authorized at the entity level, to generate required purchase orders,
- Potential for nonsupply related invoices to be paid without the appropriate entity approval as the result of an automatic match between purchase order and invoice (two-way match),
- Lack of specific authorization levels for Purchasing and AP Customer Service staff to seek approvals for material discrepancies, and
- Lack of coordinated effort between the accounts payable and affiliate accounting departments regarding cash requirement reporting and verification that material checks have been reviewed prior to printing

Management's Response

The following corrective actions were taken

- The purchasing function supporting nonsupply related purchases now report to the Director of Purchasing, where the appropriate work processes, controls, and systems are currently being managed for all supply purchases,
- Operating procedures, system scripts, and guidelines in place for processing supply purchases will be utilized for all purchases,
- A new Mode of Purchase – Fees and Services policy will be developed and forwarded to the CFOs for review and approval,
- The AP Advisory Team will establish guidelines and controls for the use of recurring payments. All other nonsupply related payments will require a three-way match, where the third match requires signature of the authorized entity leader,
- The supply and services purchase procedures will incorporate authorization levels for discrepancy resolution, and
- The AP Advisory Team will address the coordination and verification of the cash requirements and check register reconciliation



The Audit Leadership and Finance Committees
Franciscan Missionaries of Our Lady Health System, Inc
October 9, 2012
Page 4 of 7

Although not considered to be significant deficiencies or material weaknesses, we also noted the following items during our audit that we would like to bring to your attention

Terminated Users and Transfers

During our testing of removal of terminated users, we noted 5 users that still had access to the information technology system. We also noted 22 of 25 new or transferred users lacked the appropriate supervisory approval for the access granted. We recommend FMOLHS implement a policy that requires timely notification to the security administrator of terminations, transfers, and new users to ensure that the employees have appropriate access to sensitive information on the system.

Management's Response

A policy that requires timely notification to the security administrator of terminations, transfers, and new users will be established.

Review of Newly Issued or Revised Accounting Literature

FMOLHS Affiliates are not reviewing accounting policies for recently issued and adopted accounting pronouncements, specifically Accounting Standards Update No 2010-24, *Presentation of Insurance Claims and Related Insurance*.

Management's Response

We will ensure the timely review of recently issued and adopted accounting pronouncements, as well as appropriately evaluating the impact on the financial statements.

Self-Insured Employee Medical Claims Reserve

During our review of FMOLHS's self-insured employee medical claims reserve at June 30, 2012, we noted that the reserve recorded was greater than the high end of the range independently calculated by our actuarial specialists. To improve financial reporting in this area, we suggest that management review its processes and inputs for the development of this balance sheet reserve to ensure the accuracy of the amount recorded.

Management's Response

A policy will be established to review the processes and inputs for the development of this balance sheet reserve to ensure the accuracy of the amount recorded.

Management Review of Journal Entries

Certain journal entries were not reviewed and approved prior to entry into the general ledger system. All entries should be reviewed and approved by the Controller or person with similar



The Audit Leadership and Finance Committees
Franciscan Missionaries of Our Lady Health System, Inc
October 9, 2012
Page 5 of 7

supervisory responsibility over the employee preparing the entry prior to posting to the general ledger

Management's Response

A written policy will be established documenting that all journal entries will be reviewed prior to entry to the general ledger system

Management Review of Year-End Accruals

Management of Our Lady of Lourdes Regional Medical Center, Inc performed a review of payments made subsequent to year-end, however, the review did not cover a sufficient time period to ensure the accrual was adequate. In addition to performing a review of payments made subsequent to year-end, management should inquire with departments to ensure all invoices have been forwarded to the accounting department for accrual and should be reviewing for items and services received prior to year-end for which an invoice has not yet been received to ensure the year-end accruals are complete and accurate

Management's Response

Going forward, new processes will be implemented to ensure that other departments are consulted to determine if any additional accruals are needed

Estimation of Bad Debt Reimbursement

Our Lady of Lourdes Regional Medical Center, Inc is not documenting its calculation to estimate of the expected cost report settlements due to and/or from Medicare, Medicaid, and other third-party payors, which retroactively settle amounts with Our Lady of Lourdes Regional Medical Center for services provided to beneficiaries. Our Lady of Lourdes Regional Medical Center should formally document the calculation performed to estimate amounts due to and/or from these programs at the balance sheet date

Management's Response

A reconciliation will be prepared annually considering bad debt write-offs and the pass-through payments received. If determined to be material, an entry will be recorded

Maintenance and Review of Leasing Transactions

Our Lady of Lourdes Regional Medical Center, Inc is not retaining copies of all leases and subleases. Additionally, they are not reviewing the leases to determine proper payment, sublease billing, and accounting treatment



The Audit Leadership and Finance Committees
Franciscan Missionaries of Our Lady Health System, Inc
October 9, 2012
Page 6 of 7

Management's Response

A written policy will be established documenting the proper handling of all payments, billings, and accounting treatment for all leases and subleases, to include monthly review of payments, balances, and copies of all leases and subleases

Construction in Progress Accrual

In performing our search for unrecorded liabilities at Our Lady of the Lake Hospital, Inc , we identified invoices related to progress billings for construction in progress that were not accrued. We recommended that Our Lady of the Lake Hospital, Inc continue to review for unrecorded liabilities through the issuance of the financial statements.

Management's Response

We concur with the findings. We will ensure the review of unrecorded liabilities will continue through issuance of the audit report and we will request a listing of outstanding invoices directly from contractors. These additional reviews will be added to the accounting department's year-end checklist.

Settlements from Third-Party Payers

During our audit of settlements from third-party payors, we noted that St Francis Medical Center's fiscal 2012 settlements for Medicare disproportionate share (DSH) and Medicare bad debts were incorrectly calculated. To improve financial reporting in this area, we suggest that management review its associated processes and the relevant information used in the calculations for annual settlements with the Medicare program.

Management's Response

Management has reviewed the associated processes and the relevant information used in the calculation for annual settlements with the Medicare program. For fiscal 2013, a log will be maintained on a quarterly basis to capture the DSH payments and the bad debt payments. The Director of Managed Care will maintain this log. During the year-end process, this log will be reconciled to the calculation for estimating DSH and Medicare bad debt settlements. The Manager of Reimbursement will prepare the calculation for estimating Medicare DSH and Medicare bad debt settlements. The VP Finance/Controller will review the reconciliation between the log and the estimate.



The Audit Leadership and Finance Committees
Franciscan Missionaries of Our Lady Health System, Inc
October 9, 2012
Page 7 of 7

This communication is intended solely for the information and use of management, the Audit and Finance Committees, and others within the organization, and is not intended to be and should not be used by anyone other than these specified parties

Very truly yours,

KPMG LLP